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Review of Minnesota Public Utilities Commission Decisions Regarding Capital Structure Matters

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REVIEW OF MINNESOTA PUBLIC UTILITIES COMMISSION DECISIONS REGARDING CAPITAL STRUCTURE MATTERS

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I. INTRODUCTION

In every general rate proceeding, the Minnesota Public Utilities Commission must establish rates that will generate sufficient revenues to allow the utility to earn a fair and reasonable return upon its investment in property.[1] What constitutes a fair and reasonable return cannot be de-

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1. *See* MINN. STAT. §§ 216B.16(6), 237.075(6) (1982). Chapter 216B vests the Minnesota Public Utilities Commission with the power to regulate, *id.* § 216B.08, corporations operating facilities for furnishing at retail natural, manufactured or mixed gas or electric service to or for the public, *id.* § 216B.02(4). Subdivision 6 of section 216B.16 provides in part:

> The commission, in the exercise of its powers under this chapter to determine just and reasonable rates for public utilities, shall give due consideration to the public need for adequate, efficient, and reasonable service and to the need of the public utility for revenue sufficient to enable it to meet the cost of furnishing the service, including adequate provision for depreciation of its utility property used and useful in rendering service to the public, and to earn a fair and reasonable return upon the investment in such property.

Id. § 216B.16(6).

Chapter 237 vests the Minnesota Public Utilities Commission with jurisdiction and supervisory power over telephone companies doing business in Minnesota. *Id.* § 237.02. Subdivision 6 of section 237.075 provides in part:

termined with precision, but it must at least meet the following well-recognized guidelines:[2]

1. The allowed rate of return should be comparable to those being made on investments and other business undertakings attended by corresponding risks and uncertainties;

2. The return should be sufficient to enable the utility to maintain its financial integrity; and

3. The return should be sufficient to attract new capital on reasonable terms.

Additionally, to pass constitutional muster, the rates established by the commission cannot be confiscatory. Courts uniformly observe:

> Rates which are not sufficient to yield a reasonable return on the value of the property used, at the time it is being used to render the service, are unjust, unreasonable, and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[3]

In Minnesota, ascertainment of a "fair and reasonable return" is the product of a number of separate determinations made by the commission during the proceedings. These determinations, based on a cost of capital approach, are: (1) the cost of common equity; (2) the cost of preferred stock; (3) the cost of debt; and (4) the cost of any other items considered part of the capital structure. The commission must also determine the capital structure appropriate for ratemaking purposes. The cost rate for each capital item is weighted by the percent of that item in the capital structure. The commission regards the sum of the weighted cost rates as the authorized overall "fair rate of return."[4]

Defining the appropriate capital structure is of major importance in determining the overall rate of return. Even a modest adjustment in the capital structure significantly affects the utility's overall rate of return

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> The commission, in the exercise of its powers under this chapter to determine just and reasonable rates for telephone companies, shall give due consideration to the public need for adequate, efficient, and reasonable service and to the need of the telephone company for revenue sufficient to enable it to meet the cost of furnishing the service, including adequate provision for depreciation of its telephone company property used and useful in rendering service to the public, and to earn a fair and reasonable return upon the investment in such property.

Id. § 237.075(6).

2. *See* Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944); Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n, 262 U.S. 679, 690 (1923); Hibbing Taconite Co. v. Minnesota Pub. Serv. Comm'n, 302 N.W.2d 5, 10 (Minn. 1980).

3. *See, e.g.*, Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n, 262 U.S. 679, 690 (1923); Hibbing Taconite Co. v. Minnesota Pub. Serv. Comm'n, 302 N.W.2d 5, 10 (Minn. 1980).

4. A typical reflection of this process in a recent commission order is as follows:

and its additional revenue requirement.[5] A severe adjustment in the capital structure may: (1) seriously impede the utility's ability to compete in the capital markets; (2) ultimately raise the utility's overall cost of capital to the detriment of both the utility and its ratepayers; and (3) render the authorized overall return constitutionally insufficient.

Intervenors in general rate proceedings before the commission often attempt to convince the commission to adopt capital structures for ratemaking purposes that differ significantly from the utility's actual capital structure or the capital structure proposed by the utility for ratemaking purposes. Responses by the commission to these efforts vary from utility to utility, and occasionally, from case to case for particular utilities.

II. Telephone Rate Proceedings

In the past decade, the question of what is the appropriate capital structure for ratemaking purposes has been a significant issue in most major telephone rate proceedings. The commission treats the matter as a factual issue and commission decisions vary from case to case depending largely upon the nature of the expert testimony presented by the parties. The commission has sometimes expressed its preference for a "double leverage" capital structure, and in recent years, has generally deviated from that position when the Department of Public Service (DPS)[6] or other intervenors have failed to present significant double leverage testimony.

The key telephone rate proceeding in the early 1970's was initiated in 1971 by Northwestern Bell Telephone Company (Bell). Bell sought to

	Amount (000s omitted)	Percent of Total	Cost	Weighted Cost
Short Term Debt	$ 53,344	2.66%	15.18%	.40%
Long Term Debt	919,615	45.03	7.22	3.25
Preferred Stock	221,525	10.85	6.16	.67
Common Equity	846,779	41.46	13.77	5.71
Total	2,042,263	100.00%		10.03%

Northern States Power Co., Docket No. G-002/GR-80-556 (Minn. P.U.C. July 24, 1981), at 21.

5. In the *Northern States Power* proceedings, *id.*, for example, an increase in debt and a decrease in common equity of one percent would reduce the overall return by seven basis points and would reduce the overall revenue requirement by approximately $1.2 million.

6. Prior to 1980, the Department of Public Service consisted of two divisions, the Administrative Division of the Department and the Public Service Commission. Prior to 1980, the Department's Administrative Division (known as the Participating Department Staff or PDS) intervened in rate cases. In 1980, Minnesota Statutes, section 216A.01 was amended to separate the Department and the Commission. Act of Apr. 24, 1980, ch. 614, § 103, 1980 Minn. Laws 1436, 1496. Since that time the Department of Public Service (DPS) has directly intervened in cases.

obtain a general rate increase.[7] The proceeding involved capital structure issues and the commission's resolution of the issues, subsequently affirmed by the Minnesota Supreme Court, retains importance today.

Bell proposed the use of the Bell System capital structure at the end of a test year to determine a new rate of return. Based on this capital structure, Bell's witness recommended an overall rate of return on a fair value rate base of between 8.4 and 8.5%. The record established the Bell System's debt ratio at 45.14%.[8] Two other witnesses, one retained by the commission and one retained by the state, testified that Bell's debt ratio was too low and not in the best interest of the ratepayers. While not advocating adoption of a hypothetical debt ratio, one witness recommended a rate of return of 7.77% on an imputed debt ratio of 53% and a net book cost rate base. The other witness, although using the Bell System capital structure, recommended a return of 7.5% on a net book cost rate base. Their recommended returns would have been substantially lower if applied to a fair value rate base.

The commission's order did not separate the capital structure issue from the rate of return issue. Rather, the commission merely stated:

> The Commission in determining what is an overall fair rate of return must exercise its considered judgment. After reviewing all of the evidence in this case and the testimony of three expert rate of return witnesses, it is the considered judgment of this Commission that the fair rate of return which applicant should be permitted to earn on the rate base adopted herein is 7.5 percent.[9]

The commission reviewed the capital structure evidence in some detail in its subsequent order on reconsideration. It again failed to make an express capital structure determination for rate of return purposes.

The question of appropriate capital structure also affected the commission's rate base determination. At the time, Minnesota Statutes, section 237.08 required the commission to give "due consideration" to the "current value" of Bell's property.[10] Bell argued that the "fair value" of its property used and useful in providing service equaled the calculated "current value." To prove calculated current value, Bell presented evidence as to the original cost of its plant, less depreciation, and then trended original cost upward by approximately thirty percent through the use of telephone plant price indexes. The state argued that "fair value" equaled original cost.

7. Northwestern Bell Tel. Co., 93 P.U.R.3d 106 (Minn. P.S.C. 1972). The general rates Bell sought to increase in this proceeding had been in effect since April 1958.

8. AT&T's debt ratio was 21.42% and Bell's debt ratio was 35.75%.

9. 93 P.U.R.3d at 111.

10. MINN. STAT. § 237.08 (1971), *repealed by* Act of June 2, 1977, ch. 359, § 8, 1977 Minn. Laws 772, 777. This statute was replaced by a provision providing for an original cost standard instead of a current cost standard. Act of June 2, 1977, ch. 359, § 7, 1977 Minn. Laws 772, 776, *codified at* MINN. STAT. § 237.075 (1982).

The commission, in effect, adopted a reasonable compromise between the two positions. For the purpose of establishing the rate base, the commission weighted the difference between original cost and current value according to the common equity percentage contained in Bell's capital structure. The commission reasoned that this recognized the effects of inflation on the rate base in respect to equity, but excluded inflation from that portion of the rate base financed by debt.[11]

The commission's decision was appealed to the district court and, ultimately, to the Minnesota Supreme Court.[12] Both courts affirmed the commission on these issues.[13] In the supreme court, the state claimed that weighting current value based on Bell's capital structure was not supported by the record and that capital structure had no relationship or relevance to the value of property included in the rate base. The state also argued that ample evidence proved the Bell capital structure inordinately "thick" and that the commission failed to adequately address the issue by adjusting the rate of return downward to reflect Bell's low debt-equity ratio. The supreme court rejected these arguments and indicated a predisposition to management discretion in determining the appropriate capital structure:

> We have difficulty accepting the concept that in a rate case of this kind the state may collaterally attack the judgment of the company in maintaining its embedded debt at a low figure. We agree with the position of the company that this is a discretionary matter of management which, in the light of soaring interest rates, seems to vindicate the company's decision to keep its debt obligations to a minimum.[14]

Northwestern Bell's next rate application[15] again called for the com-

11. Northwestern Bell Tel. Co., Docket No. 0238-TE (Minn. P.S.C. Apr. 7, 1972) (Supp. Order), at 3-4.

12. Northwestern Bell Tel. Co. v. State, 299 Minn. 1, 216 N.W.2d 841 (1974).

13. *Id.* at 6, 14-15, 28, 216 N.W.2d at 844-45, 850, 857-58.

14. *Id.* at 14-15, 216 N.W.2d at 850.

This concept has been expressed in other jurisdictions as well. *See* Pacific Northwest Bell Tel. Co. v. Washington Util. & Transp. Comm'n, 98 P.U.R.3d 16, 25-26 (Wash. Sup. Ct. King County 1972); Pennsylvania Pub. Util. Comm'n v. Bell Tel. Co. of Pennsylvania, 93 P.U.R.3d 13, 39 (Penn. P.U.C. 1971). The Florida Public Service Commission, in Florida Power & Light Co., 67 P.U.R.3d 113 (Fla. P.S.C. 1966), set forth the general rationale for the importance of management discretion with regard to capital structure matters as follows:

> Nevertheless, capital structures, basically, fall within the prerogatives of management, and this is as it should be, because of the impact capital ratios exert on the ability of the utility to maintain its credit and attract capital. Management lives from day to day with intricate and complex problems of corporate finance, and has the responsibility of seeing that the utility has the financial ability to meet its public duties. The invasion of the field of management in such a sensitive area is justified only when the public interest requires the exercise of extreme measures for its protection and benefit.

Id. at 162; *see also* Tampa Elec. Co., 92 P.U.R.3d 398, 416 (Fla. P.S.C. 1971).

15. Northwestern Bell Tel. Co., Docket No. M-5405 (Minn. P.S.C. Nov. 22, 1974). This rate application was filed in April 1974.

mission to make capital structure determinations for rate base and rate of return purposes. In determining the fair value rate base, the commission continued to utilize Bell's equity ratio of 60.1%. The commission, however, then faced three separate capital structure recommendations for rate of return purposes. Bell proposed use of an "objective" Bell System consolidated capital structure,[16] the state recommended use of the Bell System's "actual" consolidated capital structure,[17] and the commission's consultant advocated use of a so-called "double leverage" capital structure.[18] The consultant claimed double leverage takes into account the effective cost to a holding company system of financing its operating subsidiaries. Additionally, he claimed that double leverage recognizes differences in capital costs among a parent company's various subsidiaries and, since the particular subsidiary's capital structure is utilized, it equitably spreads earnings requirements among the subsidiaries while providing the required equity return to the parent.

In its initial decision, the commission failed to separately detail the capital structure relied upon in establishing Bell's authorized return of 7.97%.[19] The commission, however, appeared to endorse the use of double leverage, stating that "the actual capital structure selected must recognize the integrated nature of capital financing which exists in a multi-tiered corporation such as AT&T."[20]

While the second Bell proceeding wound its way through an appeal to the district court, a remand proceeding, and two trips to the Minnesota Supreme Court,[21] the commission openly adopted a double leverage cap-

16. AT&T's objective consolidated capital structure consisted of 52.5% common equity, 2.5% preferred, and 45% debt.

17. The actual consolidated capital contained less equity and more debt than the AT&T objective capital structure.

18. The commission consultant's double leverage capital structure contained 48.2% debt, 4.9% preferred, and 46.9% equity.

19. Northwestern Bell Tel. Co., Docket No. M-5405 (Minn. P.S.C. Nov. 22, 1974). In fact, it can be argued, based on the commission's initial order, that the commission made no separate capital structure determination at all. It simply began with the previously authorized return of 7.5%, added .4% for increased debt costs, and then added .07% to enable Bell to attract new capital, thus arriving at an overall return that was within the range of reasonableness expressed by the witness.

20. *Id.* at 20.

21. This matter reached the supreme court on two occasions: First, on the question of whether the district court could remand the matter to the commission for further proceedings; second, on the merits of the commission's initial decision and its decision on remand reducing the authorized rate of return in accordance with the remand order of the district court. There was, however, no serious dispute on appeal with regard to the commission's capital structure determinations and the supreme court's opinions do not comment on the matter.

The supreme court initially found authority in the district court to remand the matter for further proceedings and refused to consider the merits of the matter prior to completion of the remand proceedings. *See* Northwestern Bell Tel. Co. v. State, 310 Minn. 146, 246 N.W.2d 28 (1976). When the court ultimately reached the merits, it concluded ital structure in another major telephone company proceeding. Continental Telephone Company of Minnesota, Inc. (Continental-Minnesota), a wholly owned subsidiary of Continental Telephone Corporation (Continental) and the largest non-Bell telephone company in Minnesota, filed an application for rate relief on March 7, 1975.[22] Continental-Minnesota's rate of return witness testified that the actual capitalization of Continental-Minnesota as of December 31, 1974, adjusted for a 1975 financing of preferred stock, should be utilized. The Participating Department Staff (PDS) opposed the company proposal and recommended a capital structure based on double leverage. The PDS claimed double leverage included the effective cost to Continental of financing the stock of Continental-Minnesota. Continental vigorously objected to the PDS double leverage recommendations. Continental argued that double leverage implied a rigid flow of funds that did not exist, discriminated against holding companies because investors in other operating companies may have also lowered their investment through lower priced debt, and required ratepayers in other jurisdictions that do not use double leverage to subsidize Minnesota ratepayers.

Despite this evidence, the commission openly endorsed double leverage as the appropriate capital structure for a wholly owned operating telephone company, stating:

> The Commission finds it appropriate to use a double leveraged capital structure for the Company. The Commission finds and concludes that the Parent Company used debt and preferred stock in purchasing the common equity of the Company, and that if the common equity of all the subsidiaries were totalled, it would exceed that of the Parent Company. If the Commission were not to adopt double leverage, the Parent Company's Minnesota ratepayers would be required to pay more than their proportionate share of the Parent Company's earnings requirements. The use of double leverage recognizes the differences in capital costs among the Parent Company's various subsidiaries. If double leverage were used in each jurisdiction, the Parent Company's earnings requirements would be equitably spread among the individual subsidiaries, yet the Parent Company would still have the opportunity to earn its required equity return. The Commission further finds and concludes that the use of double leverage is desirable to provide it with the necessary information required to evaluate the appropriate capital structure of the Company in Minnesota. The Commission recognizes that various other jurisdictions in which the Parent Company has subsidiaries may not employ double leverage. However, this possibility does not justify the Commission in using a non-leveraged capital structure which would in effect require the Parent Company's Minnesota ratepayers to subsidize the customers of its

that the district court erred in instructing the commission to reduce the authorized 7.97% rate of return. The supreme court reinstated the commission's initial rate of return determination. *See* Northwestern Bell Tel. Co. v. State, 253 N.W.2d 815 (Minn. 1977).

22. Continental Tel. Co., Docket No. PR-121-1 (Minn. P.S.C. Apr. 16, 1976).

subsidiaries in those jurisdictions which do not use double leverage.[23]

The commission reiterated the double leverage principles enunciated in its *Continental* decision in the Northwestern Bell case that followed.[24] In this proceeding, Bell again proposed an objective capital structure containing 45% debt.[25] Bell justified the proposal by citing a decline in the Bell System's pretax interest coverage and a need for a greater borrowing power margin to enable them to raise additional capital without impairing the company's credit rating, the quality of its securities, or its "AAA" bond rating. Bell also indicated that double leverage effectively attributed a 55.09% hypothetical debt ratio to the company.[26] Double leverage also failed to account for the fact that the timing of the issuance of debt could vary the ratio of debt to equity significantly from year to year. Bell also pointed out that double leverage was not accepted by the Federal Communications Commission or ninety percent of the states regulating the Bell System, and its use in Minnesota would deny the parent company its required rate of return.

The commission rejected Bell's proposed capital structure and arguments and adopted the PDS proposed double leverage capital struc-

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23. *Id.* at 10.

The double leverage capital structure adopted by the commission for Continental-Minnesota was computed as follows:

CAPITAL STRUCTURE (December 31, 1974) ADJUSTED FOR PROPOSED FINANCING

	Amount (000's Omitted)	%	Cost %	Weighted Cost %
Continental Telephone-Parent Common Equity Investment	$ 4,446			
Continental Telephone of Minnesota Retained Earnings	9,545			
Continental Telephone of Minnesota Common Equity	$ 13,991	26.03	12.33	3.21
Continental Telephone-Parent Preferred Stock Investment	452	.84	7.80	.07
Continental Telephone-Parent Long-Term Debt Investment	2,772	5.16	9.45	.49
Continental Telephone-Parent Interim Debt Investment	703	1.31	9.45	.12
Continental Telephone of Minnesota, Long-Term Debt	31,125	57.91	5.62	3.26
Continental Telephone of Minnesota Preferred Stock	4,700	8.75	9.75	.85
	$ 53,743	100.00		8.00

Id. at 12.

24. Northwestern Bell Tel. Co., Docket No. P-421/GR-75-496 (Minn. P.S.C. Oct. 15, 1976).

25. AT&T's consolidated debt ratio was 49.6% at the time.

26. Northwestern Bell Tel. Co., Docket No. P-421/BK-75-496 (Minn. P.S.C. Oct. 15, 1976), at 22-23.

ture.[27] Recognizing the persuasive arguments advanced by both parties, the commission stated that its primary consideration was the rates paid by subscribers within its jurisdiction, not the return to AT&T. The commission found, however, that a double leverage capital structure accounted for AT&T financing in subsidiary operating companies and thereby assured that Minnesota ratepayers contributed their equitable share of a fair return to the parent company. In the commission's view, double leverage avoided the possibility of ratepayers in one jurisdiction subsidizing those in another, an inequity a consolidated capital structure failed to address. The commission also utilized the double leverage capital structure for purposes of determining the current value adjustment to be made to the rate base pursuant to Minnesota Statutes, section 237.08.[28]

In the subsequent Bell decision arising out of a full general rate case,[29] the commission made no mention of the double leverage principle endorsed in the prior *Continental* and *Bell* proceedings. Bell proposed a structure based on anticipated end-of-test year figures for the Bell System, excluding Western Electric debt. The PDS, ignoring its former position as the champion of double leverage, proposed a capital structure that averaged actual year-end 1977 and forecast year-end 1978, including Western Electric equity and debt. The PDS proposed treatment of Western Electric lowered AT&T's equity by one percentage point and raised debt by the same amount.[30]

The commission adopted the PDS capital structure, finding it appropriate to use an average capital structure when it is to be applied to an

27. The double leverage capital structure adopted by the commission was as follows:

	%	Cost	Weighted Cost
AT&T Common Equity Investment (Incl. Conv. Pref.)	33.90	12.80	4.34
NWB Retained Earnings	8.71	12.80	1.11
AT&T Preferred Stock Investment	2.30	7.58	.17
AT&T Debt Investment	11.98	6.45	.77
NWB Debt	43.11	7.16	3.09
	100.00%		9.48

This decision was appealed to the district court because a number of other issues in this matter were closely related to issues pending before the supreme court as a result of appeals in Docket No. M-5405. After the supreme court's decision on the merits in Northwestern Bell Tel. Co. v. State, 253 N.W.2d 815 (Minn. 1977), the appeal was voluntarily dismissed. Accordingly, the commission's capital structure determination was not judicially reviewed.

28. Northwestern Bell Tel. Co., Docket No. P-421/GR-75-496 (Minn. P.S.C. Oct. 15, 1976), at 11.

29. Northwestern Bell Tel. Co., Docket No. P-421/GR-77-1509 (Minn. P.S.C. Nov. 22, 1978).

30. *Id.* at 26. The proposed capital structures were as follows:

average test year rate base.[31] Furthermore, the commission stated that the debt of a subsidiary should be included in the capital structure if the equity of the subsidiary has also been included.[32] Obviously, since neither the company nor the intervenors advocated the use of a double leverage approach, the commission ignored its earlier *Continental* and *Bell* decisions endorsing that methodology.

During 1980 and 1981, the commission issued decisions in five major telephone rate proceedings.[33] In the two Bell proceedings,[34] the company proposed use of the Bell System's consolidated capital structure. The Minnesota Department of Public Service's witness countered these proposals and advocated the adoption of a hypothetical capital structure containing 55% debt and 45% equity. In the first proceeding, the PDS witness suggested that if the commission rejected the use of the proposed hypothetical capital structure, it should adopt an actual capital structure adjusted for double leverage. The commission, in each instance, adopted the Bell System's consolidated capital structure, adjusted for Western Electric.[35]

The commission's capital structure determination in the first proceeding was appealed to district court. The DPS and the Office of Consumer Services (OCS) charged that the commission made two errors when determining appropriate capital structure. First, the commission failed to support its capital structure determination with adequate findings. Sec-

Bell		PDS	
Debt	45.8%	Debt	46.87%
Preferred Stock	2.5%	Preferred Stock	2.46%
Common Stock	51.7%	Convertible Preferred Stock	.62%
		Common Equity	50.05%

Id.

31. *Id.* at 27.

32. *Id.* An appeal to district court in this matter was voluntarily dismissed by Bell after the district court refused to stay the commission's order directing Bell to refund rates collected under bond while the matter was pending before the commission. Consequently, the commission's capital structure determination was not subject to judicial review.

33. Northwestern Bell Tel. Co., Docket No. P-421/GR-80-911 (Minn. P.U.C. Dec. 29, 1981); United Tel. Co., Docket No. P-430/GR-80-612 (Minn. P.U.C. June 30, 1981); United Tel. Co., Docket No. P-430/GR-79-644 (Minn. P.U.C. July 28, 1980); Continental Tel. Co., Docket No. P-407/GR-79-500 (Minn. P.S.C. May 9, 1980); Northwestern Bell Tel. Co., Docket No. P-421/GR-79-388 (Minn. P.S.C. Apr. 4, 1980).

34. Northwestern Bell Tel. Co., Docket No. P-421/GR-80-911 (Minn. P.U.C. Dec. 29, 1981); Northwestern Bell Tel. Co., Docket No. P-421/GR-79-388 (Minn. P.S.C. Apr. 4, 1980).

35. Northwestern Bell Tel. Co., Docket No. P-421/GR-80-911 (Minn. P.U.C. Dec. 29, 1981), at 45; Northwestern Bell Tel. Co., Docket No. P-421/GR-79-388 (Minn. P.S.C. Apr. 4, 1980), at 73.

In the 1980 decision, Western Electric's debt and equity were included in the capital structure. Northwestern Bell Tel. Co., Docket No. P-421/GR-79-388 (Minn. P.S.C. Apr. 4, 1980), at 73. In the 1981 proceeding, both were excluded. Northwestern Bell Tel. Co., Docket No. P-421/GR-80-911 (Minn. P.U.C. Dec. 29, 1981), at 45.

ond, the commission inappropriately abandoned double leverage as the proper method for determining capital structure for ratemaking purposes.

The district court rejected the first contention.[36] Noting that the burden of showing the reasonableness of the proposed capital structure, including justification of the debt to equity ratio, rested with the company, the court stated that selection of an appropriate capital structure "*is a fact* easily ascertained, and . . . supported, by its nature, only by expert opinion."[37] The court found sufficient expert opinion in the record for the commission's capital structure determination. Specifically, Bell offered three experts who advocated the consolidated capital structure proposed by the company and even a General Services Administration witness approved the Bell proposal. According to the court, only one witness called by the DPS testified to the superiority of the debt loaded hypothetical capital structure, and no study supported the position. The court concluded that the commission decision reflected the Minnesota Supreme Court's deference to management discretion in capital structure determinations.

The DPS and OCS's claim that the commission abandoned double leverage without justification was similarly rejected.[38] The district court distinguished the 1976 Bell proceeding because there the DPS produced a witness who testified to the suitability of the double leverage structure. The DPS and OCS presented no such witness in this proceeding. Their witness simply suggested that if the commission rejected the hypothetical capital structure, it should adopt Bell's actual capital structure adjusted for double leverage.[39] The witness offered no evidence to support the conclusion other than previous commission practice. The court stated that "substantial expertise recommended the Bell System consolidated capital structure" and "it cannot be error to have followed that advice absent any support, other than historical, for the double leverage capital system."[40] Indeed, the court again recognized, based on the factual nature of the issue and the lack of evidence presented by the intervenors, that the adoption of a double leverage capital structure would not have been supported by substantial evidence and would have been erroneous.

In the second Bell decision, the commission rejected hypothetical capi-

36. Northwestern Bell Tel. Co. v. Minnesota Pub. Util. Comm'n, File Nos. 446272, 445940 (Minn. 2d Dist. Ct. Sept. 8, 1981).

37. *Id.* at 7 (emphasis added).

38. *Id.* at 23-25.

39. *Id.* at 25. The district court remanded the matter to the commission for further consideration of three issues and the matter is presently pending before the commission. *Id.* Appeals to the supreme court on other issues have been stayed pending completion of the remand proceedings. *See* Northwestern Bell Tel. Co. v. Minnesota Pub. Util. Comm'n, Nos. CX-81-1036, C3-81-1072 (Minn. Nov. 9, 1981) (order staying appeals).

40. Northwestern Bell Tel. Co. v. Minnesota Pub. Util. Comm'n, File Nos. 446272, 445940 (Minn. 2d Dist. Ct. Sept. 8, 1981), at 25.

tal structure recommendations by the DPS and adopted the average 1981 Bell System capital structure, adjusted for Western Electric.[41] The structure contained 49.4% common equity, which the DPS characterized as too high and, therefore, uneconomic. The commission rejected the DPS contention because the record failed to support it.[42] The commission found that tests performed by DPS may have shown the hypothetical capital structure to be safe, yet disapproved the hypothetical structure because the DPS failed to establish that the Bell System's actual capital structure was unsafe or resulted in higher costs of capital to the Bell System than the DPS hypothetical structure. The commission also recognized the supreme court's high regard for the judgment of management when determining the appropriate capital structure and concluded that it would be inappropriate to use a hypothetical capital structure based on the record in the proceeding.

The three other major telephone rate proceedings during 1980 and 1981 involved Continental-Minnesota[43] and United Telephone Company of Minnesota.[44] The commission adopted double leverage capital structures in each instance.[45]

In the *Continental* decision, the commission found that double leverage appropriately recognized the mix of parent company financing in its subsidiaries.[46] The commission commented on the use of a consolidated capital structure approved in the Bell case scarcely a month earlier:

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41. Northwestern Bell Tel. Co., Docket No. P-421/GR-80-911 (Minn. P.U.C. Dec. 12, 1981), at 45.

42. *Id.* Petitions for reconsideration on this issue have been denied by the commission and the commission's orders have been appealed by various parties to the district court.

43. Continental Tel. Co., Docket No. P-407/GR-79-500 (Minn. P.S.C. May 9, 1980).

44. United Tel. Co. of Minnesota, Docket No. P-430/GR-80-612 (Minn. P.U.C. June 30, 1981); United Tel. Co., Docket No. P-430/GR-79-644 (Minn. P.U.C. July 28, 1980).

45. United Tel. Co., Docket No. P-430/GR-80-612 (Minn. P.U.C. July 30, 1981), at 3; United Tel. Co., Docket No. P-430/GR-80-612 (Minn. P.U.C. July 28, 1980), at 39; Continental Tel. Co., Docket No. P-407/GR-79-500 (Minn. P.S.C. May 9, 1980), at 32-33.

46. Continental Tel. Co., Docket No. P-407/GR-79-500 (Minn. P.S.C. May 9, 1980), at 32-33. The commission stated:

> [T]he most appropriate capital structure for use in determining the rates to be charged by Continental Telephone Company of Minnesota is a double leveraged capital structure. . . . [T]he use of a double leveraged capital structure for CTM appropriately recognizes the mix of CTC financing in its subsidiaries.
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> . . . .
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> The Commission will follow its double leverage precedents (also see *Northwestern Bell Telephone Company*, Docket No. P-421/GR-78-496 (October 15, 1976)) and use the accepted method of determining the overall cost of capital to CTC by use of the unconsolidated parent balance sheet.

Id.

Consistent with its earlier *Continental* decision, Docket No. PR-121-1 (Minn. P.S.C. Apr. 16, 1976), at 12, the commission refused to double leverage Continental's retained earnings on the ground that logic dispelled the assumption that the parent financed retained earnings. Continental Tel. Co., Docket No. P-407/GR-79-500 (Minn. P.S.C. May 9, 1980), at 33.

> [U]se of a consolidated capital structure as a proxy for the subsidiary capital structure would be an alternative way of recognizing this financing mix; however, such a method does not recognize the differences in capital costs among the various subsdiaries of the parent. A double leverage approach does assure that Minnesota ratepayers contribute only their equitable share of return to the parent. The Commission further notes that no parties to this proceeding proposed using the CTC consolidated capital structure as a proxy for that of CTM.[47]

Two months after this *Continental* decision, the commission decided on an application for a rate increase filed by United Telephone Company of Minnesota. United of Minnesota had proposed the use of its own capital structure consisting of 52% debt and 42% common equity. The PDS proposed use of the consolidated capital structure of United Telecom, the parent company, consisting of 57.53% debt, 4.95% preferred, and 37.51% common equity. The OCS advocated double leverage. Under the OCS method, eventually adopted by the commission, the overall cost of capital for the parent became the cost of equity for United. United of Minnesota's cost of debt was utilized, however, since it issued and remained responsible for repayment of its own debt. These cost rates were then weighted according to United of Minnesota's actual capital structure for purposes of establishing the overall authorized rate of return.[48]

In United's most recently completed proceeding, the parties stipulated to the use of essentially the same double leverage methodology that had been adopted by the commission in the prior proceedings.[49] The stipulation was accepted by the commission without significant comment.[50]

47. Continental Tel. Co., Docket No. P-407/GR-79-500 (Minn. P.S.C. May 9, 1980), at 33.

48. United Tel. Co., Docket No. P-430/GR-79-644 (Minn. P.U.C. July 28, 1980), at 38-39.

49. United Tel. Co., Docket No. P-430/GR-80-612 (Minn. P.U.C. June 30, 1981), at 3.

50. The double leverage methodology reflected in the stipulation is as follows:

United Parent Company

Type of Capital	% of Capital Structure	Cost	Weighted Cost
Long-term Debt	15.85%	8.34%	1.32%
Preferred Stock	4.45	9.45	.42
Common Equity	79.7	13.6	10.84
Total	100.0%		12.58%

United (Minnesota)

Type of Capital	% of Capital Structure	Cost	Weighted Cost
Long-term Debt	49.9%	9.56%	4.77%
Common Equity	50.1	12.58	6.30
Total	100.0%		11.07%

Id.

III. Gas and Electric Proceedings

Effective January 1, 1975, following the enactment of Minnesota Statutes, chapter 216B, gas and electric utilities became subject to statewide regulation by the Minnesota Public Utilities Commission for the first time. In addition to other broad powers, the commission received the express authority to establish "just and reasonable rates" to be charged by utilities for retail natural, manufactured or mixed gas service.[51] The authority to regulate gas and electric utilities necessarily conferred upon the commission the authority to determine what capital structure is appropriate for ratemaking purposes.[52]

Since the passage of chapter 216B in 1974, there have been a large number of rate proceedings before the commission involving major gas and electric utilities.[53] The commission's treatment of capital structure matters in some of the major gas and electric utility proceedings are surveyed below.

The first major commission decision under chapter 216B involved electric rates filed by Northern States Power Company (NSP) immediately after chapter 216B became effective.[54] In this proceeding, the commis-

51. Minn. Stat. §§ 216B.03, .16(6) (1982).

52. The commission was also given authority to control the issuance of securities. Minnesota Statutes, section 216B.49, subdivision 3, makes it unlawful for a gas or electric public utility organized under the laws of Minnesota to offer or sell any security or, if organized under the laws of any other state or foreign country, to encumber property in Minnesota unless the capital structure of the utility is approved by the commission. Prior to approval of an issuance of securities, the commission must find "that the proposed capital structure is reasonable and proper and in the public interest and will not be detrimental to the interests of the consumers and patrons affected thereby." Minn. Stat. § 216B.49(4) (1982).

The commission generally takes the position that approval of any particular capital structure under this statute is not controlling for ratemaking purposes. North Central Pub. Serv. Co., Docket No. G-010/GR-77-235 (Minn. P.S.C. Apr. 4, 1977), at 2 (while approving issuance of mortgage bonds, commission reserved right to use different capital structure for ratemaking purposes); Northern States Power Co., Docket No. E-002/GR-79-945 (Minn. P.S.C. Mar. 5, 1980), at 4 (approved of capital structure adjustments with reservation of right to use different capital structure for ratemaking). This position is in accord with the interpretation afforded 47 U.S.C. § 721(c)(8) (1976), which allows the Federal Communications Commission to review corporate borrowings. *See* Communications Satellite Corp. (COMSAT) v. Federal Communications Comm'n, 611 F.2d 883 (D.C. Cir. 1977).

53. For example, through mid-1981, Northern States Power Company filed nine separate rate proceedings totalling in excess of $396 million. Minnesota Power & Light Company filed five for more than $184 million. Minnesota Gas Company filed two for more than $45 million. Interstate Power Company had filed seven, totalling more than $15 million. In addition, 37 rate proceedings were instituted by other gas and electric utilities during this period. *See* Minnesota Department of Public Service, Utility Filings for Rate Increase by Utility 1-6. In addition, there have been a number of applications for approval for changes in capital structure filed pursuant to Minnesota Statutes, section 216B.49 (1982).

54. *See* Northern States Power Co., Docket No. ER-2-1 (Minn. P.S.C. Oct. 15, 1976).

sion chose between three alternative capital structures presented by various witnesses. The NSP witness recommended use of an average year-end 1974 and year-end 1975 capital structure, adjusted to reflect a planned sale of common stock in August 1975. The PDS witness advocated use of NSP's actual capital structure as of March 31, 1975, adjusted to reflect financing through May and the planned issuance of common stock. A third witness proposed a pro forma capital structure, using differing determination dates for debt, preferred, and equity.

Without any significant discussion, the commission concluded that the capital structure to be used was the average capital structure for the 1975 test year. The commission noted:

> The object of fixing an overall rate of return is to permit NSP the opportunity to achieve [the authorized] rate of return. Use of any capitalization other than the average capitalization would not be consistent with giving NSP the opportunity to achieve the rate of return allowed during this first year that rates are in effect.[55]

Contrary to NSP's proposal, however, the commission refused to adjust the average capital structure for the August sale of 1,750,000 shares common stock, finding that the adjustment would not have a significant impact on the average 1975 capital structure.[56]

The next commission decision involving a major gas utility concerned an application for a rate increase filed by Otter Tail Power Company.[57] While substantial dispute existed between Otter Tail and the PDS as to the cost of common equity, the parties apparently did not quarrel about the appropriate capital structure to be used in the rate of return determination.[58] The commission's decision ignores the capital structure issue; it merely reflects the use of a structure containing 49.52% long-term debt, 7.35% short-term debt, 13.89% preferred stock, and 29.24% common equity in arriving at a 9.158% overall rate of return.[59]

The third commission decision of importance involved Minnesota

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At that time, NSP provided electric service to nearly three million people in a 40,000 square mile service area in Minnesota, Wisconsin, North Dakota, and South Dakota. It also distributed gas to St. Paul and 77 other communities in Minnesota, Wisconsin and North Dakota; provided steam heating service in downtown St. Paul; and provided telephone service in the Minot, North Dakota area. Electric revenues accounted for about 83% of its total business and 80% of its electric revenues were derived from Minnesota. *Id.* at 6-7.

55. *Id.* at 17.

56. *Id.*

57. Otter Tail Power Co., Docket No. ER-17-1 (Minn. P.S.C. Feb. 26, 1976). Otter Tail Power Company filed the application in April 1975. The company, headquartered in Fergus Falls, is an investor owned operating electric utility that serves portions of rural Minnesota, North Dakota, and South Dakota.

58. Presumably no issue was raised because the common equity ratio was low and the cost of the preferred stock closely resembled the cost of Otter Tail's debt.

59. Otter Tail Power Co., Docket No. ER-17-1 (Minn. P.S.C. Feb. 26, 1976), at 7-8.

Power & Light Company (MP&L).[60] The capital structure proposed by MP&L, the capital structure proposed by the PDS, and the capital structure adopted by the commission differed somewhat.[61] The commission in its order provided no explanation for the adoption of a compromise between the proposals of the utility and the PDS.[62]

The commission handed down three decisions involving major gas or electric utilities in 1977, two concerning NSP,[63] and one involving North Central Public Service Company.[64] In the NSP electric rate case,[65] NSP again proposed use of an average capital structure for the test year which pegged equity at 36.7%, an amount greater than in its first case.[66] NSP testified that it desired to attain a common equity capitalization of 40% in order to maintain its bond rating. The PDS, on the other hand, proposed the use of a hypothetical capital structure containing 32.6% equity, an amount .09% less than had been approved in NSP's first case. The PDS strongly opposed allowing NSP to move to a 40% equity ratio.

In its decision, the commission again approved the use of an average capital structure when a projected test period is being used.[67] The commission also adopted NSP's equity ratio, stating:

> Capital structure found by this method is also subject to a test for reasonableness. *The only time the average capital structure during the test period would not be appropriate is when the proposed capital structure is unreasonable.* In the instant case, the 36.7% common equity proposed by NSP is not an unreasonable level of common equity. The finding of reasonableness in the instant case is based upon the facts and circumstances of record in this case. *The Commission does not mean to indicate approval of NSP's stated objectives with regard to its future capital structure by this decision.*

60. Minnesota Power & Light Co., Docket No. E-015/GR-76-408 (Minn. P.S.C. Dec. 17, 1976). MP&L, an investor owned utility headquartered in Duluth, provides electric energy to retail customers in a large portion of northeastern Minnesota and wholesale electric power to municipal and cooperative distribution systems in Minnesota and to its subsidiary, Superior Water, Light & Power Company, in Superior, Wisconsin.

61.

	MP&L	PDS	Commission
Long term Debt	47.92	47.97	47.95
Short term Debt	4.28	4.29	4.28
Preferred Stock	11.89	11.91	11.90
Common Equity	35.81	35.83	35.87

Id. at 36 & Appendix A at 41.

62. *Id.*

63. Northern States Power Co., Docket No. G-001/GR-76-3627 (Minn. P.S.C. Sept. 19, 1977) (gas rates); Northern States Power Co., Docket No. E-002/GR-76-934 (Minn. P.S.C. Mar. 2, 1977) (electric rates).

64. North Central Pub. Serv. Co., Docket No. G-010/GR-77-221 (Minn. P.S.C. Dec. 30, 1977) (gas rates).

65. Northern States Power Co., Docket No. E-002/GR-76-934 (Minn. P.S.C. Mar. 2, 1977).

66. *Id.* at 30.

67. *Id.*

> *The Commission can reevaluate whether the capital structure of the Company is reasonable if the common equity component of the capital structure continues to increase.* [68]

In the 1977 NSP gas proceeding,[69] the company again proposed use of the average actual capital structure for the test year. By the time of this proceeding, the equity component in NSP's capital had increased to 38.51%, a figure approaching NSP's previously stated objective of 40%. NSP reiterated the necessity of an equity component of 40% in order to maintain its financial position in the face of increased construction and to prevent the downgrading of its bonds. The PDS repeated its recommendation of a hypothetical capital structure. It recommended 35% equity, up 2.4% from the figure previously recommended in the 1977 electric proceeding. The PDS claimed the hypothetical equity amount would be more economical for the ratepayers, yet was high enough to maintain NSP's financial integrity.

In its order adopting NSP's proposed capital structure and allowing an overall return of 9.05%, the commission stated:

> The Examiner's Report suggested that the equity component is largely a judgmental factor which is perhaps best left to the discretion of management, *Northwestern Bell Telephone Company v. State*, 216 N.W.2d 841, 850, and recommended that NSP's proposed 38.51% equity ratio be adopted. The Commission finds that NSP's proposal is within a range of reasonableness and will therefore defer to management discretion.[70]

The commission, however, also cautioned NSP that "[w]ere the equity ratio to exceed 40%, the Commission would adopt a hypothetical equity ratio."[71]

The determination of the appropriate capital structure was hotly contested in the 1977 decision involving North Central Public Service Co.[72] The dispute revolved around North Central's operation as a division of Donovan Companies, Inc.[73] The several subsidiaries of Donovan Companies, including North Central, engage in diverse business activities and other merchandising activity.

North Central testified that the appropriate capital structure for ratemaking purposes could be determined one of two ways: First, the Donovan unconsolidated capital structure could be used. Second, for purposes of ascertaining the equity component, all of Donovan's invest-

68. *Id.* (emphasis added).

69. Northern States Power Co., Docket No. E-002/GR-76-3627 (Minn. P.S.C. Sept. 19, 1977).

70. *Id.* at 13.

71. *Id.*

72. North Central Pub. Serv. Co., Docket No. G-010/GR-77-221 (Minn. P.S.C. Dec. 30, 1977).

73. Donovan Companies, Inc., is an Iowa corporation. North Central distributes natural gas in portions of Minnesota and Iowa, sells propane and engages in other merchandising activities.

ments in its subsidiaries and the net worth of operating divisions outside Minnesota could be eliminated from Donovan's capital structure, and all long term debt secured by North Central's assets could represent the debt component. Use of either method resulted, according to North Central, in a equity debt ratio of 51% to 49%.

The PDS proposed use of a hypothetical capital structure of 40% equity and 60% debt. The PDS based its recommendation on its witness' view that it was impossible to determine a capital structure solely for North Central because it was not a separate corporate entity or a stock issuing company. The PDS rejected use of Donovan's capital structure because Donovan was not a pure utility. The PDS proposed hypothetical capital structure resulted from an averaging of twelve retail gas distribution companies in the Value Line data base.[74]

The commission carefully considered the capital structure issue, first focusing upon whether it could impose a hypothetical capital structure, and then considering whether it should do so in this case. Not unexpectedly, the commission concluded that it could impose a hypothetical capital structure if the utility's actual capital structure was unreasonable. In reaching this determination the commission considered the supreme court's opinion in *Northwestern Bell Telephone Co. v. State*[75] and concluded that although the court viewed capital structure as a matter of management discretion, the commission was not foreclosed from the imposition of hypothetical structures in rate cases where the company's actual structure was unreasonable.[76] The commission supported its opinion by quoting the statement of a leading authority on utility regulation:

> The *right* of commissions to consider this area [capital structure] in setting rates cannot be questioned, since a commission has an obligation to protect the consumer from excessive wages, excessive pension provision, excessive prices for purchased materials and supplies, and other such things, including excessive costs of capital. On the other hand, the right, while always there, should be exercised sparingly, since the problems of corporate finance are extremely intricate and complex, and are best known to the utility which lives with these problems from day to day.[77]

The commission, however, then reluctantly decided that the record before it failed to support the imposition of a hypothetical capital structure.[78] The commission observed that, although North Central was simply a division of Donovan Companies, it possessed an historically

74. *See id.*

75. 299 Minn. 1, 216 N.W.2d 841 (1974).

76. North Central Pub. Serv. Co., Docket No. G-101/GR-77-221 (Minn. P.S.C. Dec. 30, 1977), at 14-15.

77. *Id.* at 15, *quoting* P. GARFIELD & W. LOVEJOY, PUBLIC UTILITY ECONOMICS 130 (1964).

78. *Id.* at 15-16.

attributed capital structure usable for rate proceedings.[79] Furthermore, the PDS failed to furnish a rationale for rejecting the use of either North Central's historically attributed capital structure or Donovan Companies' unconsolidated capital structure.[80] The commission found no reason to believe the hypothetical capital structure proposed by the PDS was more desirable than North Central's proposals.[81] Expressing doubt as to whether either of the two capital structures the company proposed were within the range of reasonableness, the commission stated that it must accept one of them because the PDS failed to offer a viable alternative.[82] The commission adopted the capital structure of Donovan Companies on an unconsolidated basis, but stated its suspicion that the equity components of the adopted capital structure remained unreasonably high.[83] Finally, the commission cautioned North Central and the PDS that "[s]hould the company file a future rate case and propose a similar capital structure, the commission will expect the PDS to carefully scrutinize this structure and offer an acceptable alternative."[84]

The commission, in 1978, addressed capital structure issues in three major gas and electric utilities decisions. These decisions involved Minnesota Power & Light Company,[85] Northern States Power Company,[86] and Minnesota Gas Company.[87]

In the MP&L case,[88] one of the capital structure issues related to the amount of short-term debt to be included in the capital structure. MP&L included $1,000,000 of short-term debt while the PDS recommended $5,000,000 of short-term debt, half of MP&L's emergency credit line of $10,000,000.[89] The PDS argued that the flexibility represented by the emergency credit line was maintained primarily for benefit of MP&L stockholders, who should pay for it. As an alternative to including

79. *Id.* at 16.

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.* Earlier in 1977, North Central had sought and obtained permission from the commission to sell $5 million of first mortgage bonds secured by its natural gas distribution assets. The commission approved that issuance of securities in North Central Pub. Serv. Co., Docket No. G-101/GR-77-235 (Minn. P.S.C. Apr. 4, 1977), specifically finding that a capital structure containing 69.7% common equity was "reasonable and proper and in the public interest and [would] not be detrimental to the consumers and patrons affected thereby." *Id.* at 2. The commission specifically reserved the right to use a different capital structure for purposes of setting rates to be paid by North Central's retail customers. *Id.*

84. North Central Pub. Serv. Co., Docket No. G-010/GR-77-221 (Minn. P.S.C. Dec. 30, 1977), at 16.

85. Docket No. E-015/GR-77-360 (Minn. P.S.C. Feb. 3, 1978).

86. Docket No. E-002/GR-77-611 (Minn. P.S.C. Mar. 20, 1978).

87. Docket No. G-008/GR-77-1237 (Minn. P.S.C. Oct. 2, 1978).

88. Docket No. E-015/GR-77-360 (Minn. P.S.C. Feb. 3, 1978).

89. MP&L's credit line was for use in emergencies or in the case of unforeseen problems in long-term financing.

$5,000,000 in short-term debt, the PDS recommended that 0.025%, which corresponded to the commitment fee necessary to maintain the line of credit, should be eliminated from the short-term debt component in the capital structure.[90] The examiner accepted MP&L's position that $1,000,000 was the appropriate dollar level of short-term debt, but also accepted the PDS recommendation to reduce the short-term debt component in the capital structure by 0.025% due to the commitment fee. The commission, without any separate analysis or discussion, agreed and reduced the debt component of MP&L's capital structure.[91]

The parties also disputed how Superior Water, Light & Power Company (Superior), MP&L's wholly owned subsidiary, should be treated for capital structure purposes. MP&L included its equity investment in Superior in its proposed capital structure, but excluded Superior's debt. The PDS initially recommended removal of all the Superior equity from the capital structure. After MP&L testified that for ratemaking purposes the Wisconsin commission prorated Superior's capital structure, however, the PDS modified its recommendation and urged that Superior's common equity and preferred stock be eliminated from MP&L's capital structure on a prorated basis. This reduced MP&L's common equity by approximately $4.6 million and preferred stock by approximately $1.6 million. The examiner adopted the PDS revised recommendation and the commission again followed the recommendation without significant discussion.[92]

90. Commitment fees for MP&L's credit line totalled $105,000 annually, and if applied to $1,000,000 of short-term debt, would result in an effective cost of 16.5%. If applied to $5,000,000 of short-term debt, the commitment fee would result in an effective cost of 8.10%.

91. *Id.* at 20.

92. *Id.*

The real dispute in this case, as in most, centered upon the return on common equity allowed MP&L. The commission followed its so-called "*North Central* doctrine" (accepting the lowest rate of return recommendation that withstood cross-examination) and established a return on common equity of 13%. In doing so, the commission noted:

> A rate of return of 13.0% on common equity will maintain MP&L's pre-tax coverage including AFDC above 3.5% for the test year. This is the figure which Standard & Poor's told the Company it must maintain to keep its A bond rating. While coverage ratios will slide in the latter half of 1978, we expect the Company will soon return for rate relief and that we will be able to address this problem under the facts as they then exist.

Id. at 28.

Even prior to the decision, however, MP&L's bonds were downgraded. In addition, shortly after the decision, MP&L was unable to sell common equity at book value. In April 1978, a sale of $1,500,000 of common stock brought net income to MP&L of 96% of book value and an issuance in March 1979, brought only 86% of book value.

On appeal, the district court determined that a 13.0% return on equity was an insufficient rate of return and concurred with the examiner's decision that the appropriate range for return on equity was between 13.25% and 14.0%. The Minnesota Supreme Court ultimately affirmed that determination. Hibbing Taconite Co. v. Minnesota Pub. Serv. Comm'n, 302 N.W.2d 5 (Minn. 1980). In addition to rejecting the *North Central* doctrine, In the 1978 NSP decision,[93] the capital structure issue avoided serious scrutiny because NSP remained below the 40% equity level established in the earlier NSP decision.[94] The PDS also accepted as reasonable NSP's estimates of its cost of long-term debt, preferred stock, and short-term debt. The commission adopted the stipulated figures and the proposed capital structure, noting its directive in the most recent NSP gas case in which it approved an equity component approaching 40% as reasonable and rejected the PDS hypothetical capital structure.[95]

In October 1978, the commission issued its decision on the first rate increase application filed by Minnesota Gas Company (Minnegasco)[96] since statewide regulation began in 1975. According to the commission's decision, Minnegasco avoided a general rate increase during the first few years of statewide regulation because, immediately prior to the implementation of statewide regulation, the company raised its rates significantly to offset rising costs in subsequent years.[97] The commission pointed out that previous regulatory freedom allowed management to devise and implement financial policies that provided investors with financial protection. The commission concluded that "[t]his fact makes Minnegasco's record of growth unique and helps explain its strong market to book ratios throughout years of trial for the industry generally."[98]

While Minnegasco's capital structure avoided serious dispute, the commission relied on the company's strong capital structure as justification for allowing a reduced rate of return. The capital structure proposed by Minnegasco contained 42.63% long-term debt, 5.22% short-term debt, 10.29% preferred stock, and 41.86% common equity. The commission expressed doubts about the reasonableness of the common equity component, but accepted it and Minnegasco's proposed capital structure because no party challenged the proposal.[99] It is clear from the commission's decision, however, that it took Minnegasco's 41.86% equity ratio into account in establishing a return on equity of 12.47%; a return less than those allowed in recent proceedings involving NSP, Otter Tail

the supreme court particularly noted that in the 1976 MP&L proceeding the commission had determined that 13.25% was MP&L's minimum rate of return on common equity and there was nothing in the record which indicated why that position should be abandoned one year later. The supreme court also noted that MP&L's bonds had been downgraded from "A" to "A-" during the proceedings. *Id.* at 12.

93. Docket No. E-002/GR-77-611 (Minn. P.S.C. Mar. 20, 1978).

94. *See supra* notes 63-71 and accompanying text.

95. Northern States Power Co., Docket No. E-002/GR-77-611 (Minn. P.S.C. Mar. 20, 1978), at 20.

96. Docket No. G-008/GR-77-1237 (Minn. P.S.C. Oct. 2, 1978).

Minnesota Gas Company is a natural gas distribution utility serving approximately 225 communities in Minnesota, Nebraska, South Dakota and Iowa. The major communities served in Minnesota include Minneapolis and its suburbs.

97. *Id.* at 40-41 & n.5.

98. *Id.* at 42.

99. *Id.* at 31.

Power Company, and MP&L.[100] The commission noted Minnegasco's extremely strong capital structure, and found its equity ratio to be higher than any regulated utility in Minnesota. Commenting that Minnegasco's high equity ratio represented considerable protection to equity holders and indicated unsurpassed financial strength and integrity, the commission reiterated its position stated in the 1978 NSP case that a "40% equity ratio . . . represented 'the very upward limit of the point which the commission deemed reasonable.' "[101] The commission concluded that it could not "ignore the considerable element of financial protection that this structure provides the investor, and its correspondent effect on the perceived risk of Minnegasco vis-a-vis other regulated utilities with substantially greater debt leverage."[102]

In 1979, the commission issued additional decisions involving MP&L[103] and NSP.[104] In the MP&L matter, the commission considered two capital structure issues. The quarrel over the treatment of the cost of maintaining MP&L's credit line continued, and the commission again excluded commitment fees for short term financing from the capital structure.[105]

The second capital structure issue concerned whether $111,000,000 of pollution control bond proceeds should be included in the capital structure from the time of issuance of the bonds or from the time the proceeds were withdrawn from the trust fund for use by MP&L. The OCS and the PDS favored immediate inclusion, whereas MP&L included the proceeds as they were released to the company by the indenture trustee.[106] For purposes of establishing MP&L's rate of return, the commission utilized a capital structure containing 35.65% equity, 10.58% preferred stock, and 53.77% long term debt.[107] It rejected including the unused bond proceeds, stating that inclusion would have a significant and adverse impact on the company's equity ratio and resultant coverage ratio, that neither the PDS or OCS addressed these serious ramifications, and

100. *See id.*

101. *Id.* at 43, *quoting* Northern States Power Co., Docket No. 002/GR-77-611 (Minn. P.S.C. Mar. 20, 1978), at 13; *see supra* notes 63-71 & 94-95 and accompanying text.

102. Minnesota Gas Co., G-008/GR-77-1237 (Minn. P.S.C. Oct. 2, 1978), at 43.

103. Docket No. E-015/GR-78-514 (Minn. P.S.C. Apr. 9, 1979).

104. Docket No. G-002/GR-78-0152 (Minn. P.S.C. Sept. 21, 1979).

105. Minnesota Power & Light Co., Docket No. E-015/GR-78-514 (Minn. P.S.C. Apr. 9, 1979), at 63-64.

106. The company invested the unused proceeds of the pollution control bonds in short term commercial paper and government securities yielding a higher interest rate than MP&L's cost of the bonds. MP&L claimed that this was the first reinvestment in its history to be placed at a return greater than cost. In all other cases of prefinancing where capital funds were invested until needed, the return on investment was less than the capital cost and the loss had been absorbed by MP&L shareholders. *Id.* at 62.

107. *Id.* at 64. In this case, the commission allowed MP&L only a 13% return on equity. It also, however, allowed MP&L a current return on a substantial portion of its construction work in progress. *Id.* at 10, 22.

that the record was undeveloped on the potentially adverse consequences to the company, its investors, and the ratepayers.[108]

In the 1979 *NSP* decision, the commission, true to its prior admonitions to NSP, adopted a hypothetical capital structure containing 40% equity and shifted 1.56% of equity to the long term debt component of the capital structure.[109] The average test year capital structure proposed by NSP for the test year ending December 31, 1979, contained 41.56% equity.[110] NSP testified that growth in equity since 1976 resulted from NSP's dividend reinvestment program, its employee stock ownership plan, and additional retained earnings. The objective capital structure was stated to be 40 to 42% common equity. NSP's witnesses testified that increased business risks required such a capital structure. Furthermore, the proposed structure would enable NSP to avoid selling securities in unfavorable markets.

The witness for the City of St. Paul testified that a capital structure with an equity component of 35 to 40% would be appropriate. Comparing NSP's equity ratio with the average for a group of normalized electric and gas utilities whose bonds had been rated "AA," the witness found that during 1978 and 1979 NSP's equity component exceeded the average of the group. The witness concluded that NSP's equity ratio surpassed that necessary to maintain a "AA" rating. After examining the pretax interest coverage necessary to maintain a "AA" bond rating, the witness testified that the adoption of the city's recommended capital structure would continue to provide NSP with a pretax interest coverage ratio greater than Standard & Poors' requirement for a "AA" rating.

Both the OCS and the PDS used NSP's proposed test year capital structure in determining NSP's overall cost of capital. Their witnesses, however, testified that NSP's equity ratio equaled the "upper limits of a necessary or reasonable ratio." The examiner also adopted NSP's proposed equity ratio for purposes of determining NSP's cost of capital.

The commission, on the other hand, found unconvincing the company's explanation for exceeding the clearly articulated limit of reasonableness of 40%. It rejected NSP's capital structure, stating:

> The Commission has plainly stated its concern that an overly high equity ratio will impose too great an effective cost of capital on NSP's ratepayers. Company management has had the 40% upper limit as a guide for their choices and actions since September 1977. They have been put on notice that the Commission would take corrective action if that 40% point were to be passed.
>
> The City of St. Paul suggested several ways in which the Company

108. *Id.* at 63.

109. Northern States Power Co., Docket No. E-002/GR-78-0152 (Minn. P.S.C. Sept. 21, 1979), at 31-32.

110. *Id.* at 28. NSP's equity ratio had been on a purposeful upward trend, moving from 29.4% (with short term debt) in 1968 to 40.5% (with short term debt) in 1978. *Id.*

> could have controlled equity expansion. The Commission is willing to allow NSP's management to pursue whatever course of action they feel is prudent in regard to the manner of issuing common equity. The Commission is here concerned about the proper level of equity to be used for rate-making purposes. The actual level of equity has now risen above the level repeatedly labeled as reasonable by the Commission.
>
> Therefore, the Commission will adopt a hypothetical capital structure for NSP. The common equity position will be 40%, the upper limit of reasonableness. The capitalization removed from the equity component will be shifted to the long-term debt component. This shifted capitalization will be included at a cost of 9.50%, which is the recommendation of [St. Paul's witness], and which represents the approximate current cost of long-term debt to the Company.
>
> The Commission further states that it will continue to give 40% as the maximum reasonable equity rate for NSP until it is clearly and convincingly shown that any higher ratio would be reasonable. If the equity ratio remains above the reasonable maximum, the Commission will continue to use a theoretical capital structure in future cases.[111]

In April 1981, the commission issued another decision on a Northern States Power Company application.[112] By the time of this decision, NSP had reacted to the commission's 1979 order that adopted a hypothetical capital structure and had taken action to attempt to reduce its common equity level. In March 1980, NSP began to use market stock for its employee stock ownership plan and dividend reinvestment plan, rather than issuing new common stock. It also purchased approximately $1.5 million shares of common stock through market and block transactions by August 1980. As a result of these actions, NSP's proposed capital structure in this proceeding for the projected test year contained an equity ratio of 42.23%.[113]

NSP argued that the increase in the common equity ratio to 42.23% resulted from actions necessary to increase the inadequate equity ratios

111. *Id.* at 31-32.

112. Northern States Power Co., Docket No. E-002/GR-80-316 (Minn. P.U.C. Apr. 30, 1981).

113. *Id.* at 25. This equity ratio was higher than the ratio the commission had rejected in the 1979 proceeding. *See supra* note 110 and accompanying text. In February 1980, however, the commission had approved substantial changes in NSP's capital structure under Minnesota Statutes, section 216B.49. More specifically, by its order in Northern States Power Co., Docket No. E-002/GR-79-945 (Minn. P.U.C. Feb. 20, 1980), the commission had approved the issuance of $45 million worth of common stock, up to $50 million of first mortgage bonds, up to $8 million of pollution control revenue bonds, and up to $100 million of unsecured short-term promissory notes to be issued to commercial banks and to be used for commercial paper transactions. *Id.* at 1-5. As noted in that order, as of December 31, 1978, December 31, 1979, and December 31, 1980, NSP (Minnesota) would have a capital structure containing 41.9%, 43.6% and 46.3% common equity. *Id.* at 2. NSP (consolidated) would have a capital structure containing 40.5%, 42.3%, and 44.4% common equity on the same dates. *Id.*

of the mid and early 1970's, the advantageous use of dividend reinvestment in employee stock ownership plans, and the necessary cancellation of some debt offerings. NSP maintained that it had taken every reasonable action to attempt to limit or actually reduce its common equity ratio following the commission's previous orders. The company claimed its equity ratio paralleled other "AAA" rated electrics and that a developing concensus within the financial community indicated that the electric utility industry should achieve higher common equity ratios. Industry ratios had increased in recent years with most, if not all, "AA" electric utilities raising their equity ratios to over 40%. NSP also asserted that its target equity ratio of 40 to 42% was necessary to properly reflect the risks of the electric utility business and to provide financial flexibility. The expansion in the test year equity level above the 42% target, the company claimed, would not result in increased costs to consumers in the long run and would allow NSP needed financial flexibility.

The DPS and OCS recommended use of a 40% hypothetical equity ratio, claiming that NSP's actual equity ratio was excessively high and imposed an unnecessary financial burden on ratepayers. Their witness testified that the 1979 equity ratio for twenty-seven "AA" normalized electrics averaged only 37.5% and that in 1979, NSP's pretax interest coverage ratio ranked second among all the electric utilities companies. According to their witness, using both the DPS and OCS recommended capital structure and return on capital, NSP's pretax interest coverage would be 4.23; a level the witness regarded as adequate to maintain NSP's "AA" rating.

The hearing examiner found that NSP's estimated test year capital structure should be used in determining the overall rate of return. The examiner stated that the concept of a hypothetical capital structure is nothing more than a technique to reduce the overall cost of capital by declaring by fiat that the proportion of common equity shall be deemed for ratemaking purposes to be something less than it is in reality. The examiner also noted that in view of the diminishing spread between the cost of equity and the cost of debt, and in view of NSP's serious efforts to reduce its equity levels, the test year equity level of 42.23% was not unreasonable.

NSP's arguments prevailed and the commission approved the use of NSP's estimated test capital structure for calculating the overall rate of return to be allowed NSP, despite the 40% limitation established in 1979.[114] The commission specifically found a good faith effort by NSP to move toward a more reasonable capital structure in response to the commission's prior orders. The commission also recognized changed circumstances since its previous determination of a 40% upper limit of

114. Northern States Power Co., Docket No. E-002/GR-80-316 (Minn. P.U.C. Apr. 30, 1981), at 26.

reasonableness. Specifically, the commission noted that inflation and financial market conditions in the test year indicated that NSP and its customers may benefit from the increased financial flexibility afforded NSP by its new equity level. The commission, however, added the caveat that it "retains an active interest in seeing that NSP's equity ratios stay within reasonable limits and reserves the right to re-examine the appropriateness of NSP's equity ratio if circumstances warrant."[115]

In April 1981, the commission also considered an Otter Tail Power Company (Otter Tail) rate application.[116] Otter Tail filed a forecast year-end 1980 capital structure consisting of 50.58% long-term debt, 16.76% preferred stock, and 32.66% common equity. Otter Tail argued that the rate levels it requested were designed to be operative into the future and that the use of the year-end capital structure matched recent capital costs with future rates. Because the company recently experienced a dramatic rise in both its current and embedded cost of debt, Otter Tail argued that any capital structure other than the one forecasted to exist at the end of the test year seriously understated its cost of capital for the effective period of the rates to be established by the commission.[117]

Otter Tail suggested, as an alternative to the forecast year-end capital structure, that its "goal" capital structure consisting of 50% long-term debt, 13% preferred stock, and 37% common equity be utilized. Otter Tail argued that adoption of its "goal" capital structure would support its "A" bond rating.

The DPS proposed the use of a test year average capital structure consisting of 51.09% long-term debt, 16.30% preferred stock, and 32.61% common equity. The DPS derived these figures by averaging the actual capital structure of December 31, 1979 with the company's forecast of its year-end 1980 capital structure. It argued that this represented the reasonable balance between known and forecast figures and matched the test year average rate base used in the proceeding.

The commission rejected the DPS recommendations and adopted Otter Tail's forecast year-end capital structure as appropriate. Facts that convinced the commission to deviate from its prior decisions approving an average test year capital structure included:

(a) Otter Tail's participation in active financing during the test period;

115. *Id.*

116. Otter Tail Power Co., Docket No. E-017/GR-80-277 (Minn. P.U.C. Apr. 13, 1981).

117. *Id.* at 18. No one disputed Otter Tail's forecast of its embedded cost of long-term debt of 8.48% on December 31, 1980, or its cost of preferred stock of 8.46% on that date. *Id.* Similarly, there was no dispute as to the forecast levels of long-term debt, preferred stock, and common equity as of December 31, 1980. *Id.* at 19.

(b) Current costs of long-term debt and preferred stock remained well above embedded cost levels;

(c) The rates reflective of the year-end capital structure became effective only after half the test year passed and those rates were "likely to exist for at least 6 months beyond the test year"; and

(d) Otter Tail's proposed year-end capital structure forecasted a "reasonable measure of the relative levels of long-term debt, preferred stock, and common equity associated with provision of service during this time."[118]

In mid-June 1981, the commission issued its decision on North Central's second rate application since the initiation of regulations in 1975.[119] Consistent with the commission's decision in North Central's 1977 rate application, the company proposed the use of the test year average capital structure of Donovan Companies, Inc., on an unconsolidated basis. This capital structure contained 55.06% common equity and 44.94% debt.

The DPS and OCS sponsored witness testified that North Central's equity ratio exceeded the level appropriate for a gas distribution company and that the high equity ratio increased the overall cost of capital and placed an unnecessary burden on North Central's ratepayers. Their witness proposed a hypothetical capital structure containing 45% equity and 55% debt. The witness based the recommendation on a determination that the average common equity ratio of sixteen companies studied was 44.8% at the year end 1979 and that the average common equity ratio of gas companies listed in the Value Line Investment Survey was 44.5% for the same period. He claimed none of the sixteen companies studied had a common equity ratio as high as Donovan's.

During rebuttal, North Central vigorously opposed the imposition of a hypothetical capital structure on three grounds. First, North Central indicated that some of the companies studied had higher common equity ratios than Donovan. Second, North Central disputed the DPS/OCS witness' treatment of the preferred stock of the studied gas companies as debt, instead of equity capital. If the preferred stock of the companies studied was treated as equity capital, Donovan's capital structure, which did not include any preferred stock, neared the median of the group of companies studied. Third, North Central pointed out that imputation of preferred stock to the company based on an average would increase the difficulty of meeting coverage requirements on the company's bond indentures and might foreclose the issuance of new debt.

Finding the DPS/OCS witness "singularly unpersuasive," the commis-

118. *Id.*

119. North Central Pub. Serv. Co., Docket No. G-010/GR-80-472 (Minn. P.U.C. June 19, 1981).

sion rejected the proposed use of a hypothetical capital structure.[120] The commission faulted the witness' use of 1979 data to establish an equity ratio for the test year of 1981, while the witness recognized the existence of a trend towards higher common equity ratios for gas distribution companies.[121] The commission criticized the witness for treating preferred stock as debt, while at the same time recognizing that preferred stock resembled equity, with tax consequences similar to common stock and a cost higher than that of debt.[122] The commission also noted that the witness failed to respond to the company's contention that the DPS/OCS proposed hypothetical capital structure would render North Central unable to issue debt under the terms of its bond indenture.[123] Finally, the witness did not show that the hypothetical capital structure was desirable, or establish the reasonableness or desirability of the individual capital structures of the sixteen companies on which the proposal was based, as required in the previous North Central case.[124] The commission concluded:

> The Commission finds that equity ratios of natural gas distribution companies have been increasing recently; that because the Company has no preferred stock its common equity ratio can be higher than that of a gas distribution company which has preferred stock; that the Company's equity ratio is not out of line with the equity ratios of comparison companies; and that no testimony has shown the Company's proposed capital structure to be unreasonable.[125]

The commission's most recent decision in a pending NSP case was issued in July 1981.[126] NSP again proposed to use the average capital structure for the test year to calculate its weighted cost of capital. As originally presented, the projected common equity ratio was 43.14%. During the proceedings, however, NSP revised its estimated capital structure to take additional actual data into account and reduced its equity ratio to 41.46%.

The DPS again proposed use of a hypothetical common equity ratio of 40% and assigned all equity above the 40% level to debt at a cost rate of 12.62%, based on the average Standard & Poors "AA" monthly composite bond yield for the third quarter of 1980. The DPS, relying upon the commission's 1979 NSP decision that imposed a hypothetical 40% equity ratio, claimed that NSP's pretax coverage ratio and equity ratio ex-

120. *Id.* at 8-9.

121. *Id.* at 8.

122. *Id.*

123. *Id.*

124. *Id.*, *quoting* North Central Pub. Serv. Co., Docket No. G-101/GR-77-221 (Minn. P.S.C. Dec. 30, 1977), at 15-16; *see supra* notes 72-84 and accompanying text.

125. North Central Pub. Serv. Co., Docket No. G-010/GR-80-472 (Minn. P.U.C. June 19, 1981), at 8-9.

126. Northern States Power Co., Docket No. G-002/GR-80-556 (Minn. P.U.C. July 24, 1981).

ceeded those of comparable utilities. Furthermore, the DPS maintained that the hypothetical capital structure posed no threat to NSP's bond rating.

The commission rejected the DPS recommendations.[127] The commission noted that it previously ratified NSP's estimated capital structure in the recent electric rate proceeding.[128] That proceeding established good faith efforts by the company to move towards a more reasonable capital structure and acknowledged possible changes in circumstances since imposition of the 40% limit on equity. The commission stated that nothing in the present record altered its approval in the NSP electric case of an equity ratio exceeding 40%. Additionally, the 41.46% equity ratio NSP presently advocated fell below the equity ratio accepted in the electric case as reasonable, thereby reducing the desirability of imposing a hypothetical capital structure in the instant case.[129]

The final major gas and electric decision issued by the commission in 1981 again involved Minnegasco.[130] In this proceeding, Minnegasco proposed using a test year average capital structure containing 37.88% long-term debt, 9.25% preferred stock, and 52.87% common equity. The DPS witness offered no objection to Minnegasco's proposed capital structure, focusing attention solely on the cost of common equity. Since the company's capital structure recommendations went uncontested, both the examiner and the commission found it appropriate to use the unchallenged test year capital structure containing 52.8% common equity for purposes of establishing Minnegasco's cost of capital.[131] As in Minnegasco's first rate proceeding in 1977, however, the commission relied upon the company's high equity ratio as one justification for allowing a return on equity lower than that allowed North Central only two months earlier.[132]

Another gas and electric utility decision examining capital structure issues involved Peoples Natural Gas Company (Peoples).[133] The issues in this proceeding paralleled those of the North Central cases because Peoples, like North Central, is merely an operating division of a corporation, InterNorth, Inc.[134]

127. *Id.* at 13.

128. *Id.*, *citing* Northern States Power Co., Docket No. E-002/GR-80-316 (Minn. P.U.C. Apr. 30, 1981), at 26; *see supra* notes 112-15 and accompanying text.

129. Northern States Power Co., Docket No. G-002/GR-80-556 (Minn. P.U.C. July 30, 1981), at 13.

130. Minnesota Gas Co., Docket No. G-008/GR-80-630 (Minn. P.U.C. Aug. 27, 1981).

131. *Id.* at 22.

132. *Id.* at 32. An exhibit in the proceeding also showed, according to the commission's order, that Minnegasco's achieved rate of return on book equity exceeded the return authorized in every year since 1975. *Id.*

133. Peoples Natural Gas Co., Docket No. G-011/GR-80-850 (Minn. P.U.C. Nov. 25, 1981).

134. InterNorth, Inc., is an investor owned gas utility, selling natural gas in southeastern and east central Minnesota, a portion of northwestern Minnesota, and to several large customers located on the Iron Range.

Peoples proposed use of the test year average capital structure of InterNorth, Inc., containing 53.247% common equity at a cost of 16%. The DPS recommended use of a hypothetical capital structure containing 45% equity at a cost of 13.550%.

The witness for Peoples testified that the company's proposed capital structure was beneficial and economical to the ratepayers. It preserved existing bond ratings, thereby reducing the cost of borrowing, and avoided the limitations upon the availability of capital that accompany bond downgradings. The structure also preserved financial flexibility and allowed Peoples to avoid financing during periods of high interest rates. The witness testified that common equity ratios for natural gas distribution companies rose from 42.0% in 1971 to 47.7% in 1979, while the combined preferred and common equity ratios increased from 47.7 to 53.4% over the same period. This trend, according to the Peoples witness, reflected the increasing risks of the gas distribution business during periods of high interest rates and inflation.

The DPS witness testified that InterNorth's capital structure should be modified to recognize the major differences between comparable companies and InterNorth and recommended a hypothetical capital structure for this purpose. The hypothetical capital structure adjusted InterNorth's equity ratio downward from 53.2 to 45% and allocated the difference to other components of the capital structure at embedded cost rates.

On rebuttal, Peoples challenged the DPS testimony by showing that the group of comparable companies used by the DPS witness had an average equity ratio of 49.9% and a combined preferred and equity ratio of about 58%. Peoples argued that current, not embedded, costs should be assigned to any equity allocated to other components of the capital structure.

The examiner adopted the DPS proposal and recommended use of a 45% hypothetical equity ratio. The commission rejected the examiner's recommendation and adopted People's proposed capital structure.[135] The commission held that the DPS failed to show that InterNorth is more risky than its Peoples division. On this point, the commission stated:

> What was established is that InterNorth had divisions which present more risk than typical gas distributors. However, as a general rule, diversification tends to reduce risk. The DPS evidence with respect to beta and standard deviation of price change suggests InterNorth is slightly more risky than typical gas distributors, but other factors evaluated—level of revenues, common equity ratio, pretax coverage ratio, and dividend payout ratio—tend to show InterNorth presents less risk to investors. Thus, it cannot be concluded, on the basis of evidence

135. Peoples Natural Gas Co., Docket No. G-011/GR-80-850 (Minn. P.U.C. Nov. 25, 1981), at 14.

presented, that InterNorth is more risky than a typical gas distributor.[136]

Furthermore, the commission held that even if InterNorth presented greater risks than Peoples, the DPS must show that "this excess risk had manifested itself in a common equity ratio which was too high."[137] According to the commission, the DPS failed to show this.

In *North Central Public Service Co.*,[138] the commission again held that the Donovan Companies, Inc., unconsolidated capital structure was the appropriate capital structure to be applied for ratemaking purposes. The commission rejected the DPS proposed hypothetical capital structure and followed its earlier *North Central* decisions, noting that the use of the DPS hypothetical capital structure would tend to push North Central's "earned return on equity below its allowed return on equity." The commission stated that it would be inappropriate to lower North Central's return on equity "in the absence of convincing evidence that the Company's proposed capital structure is unreasonable."[139] The DPS failed to show that North Central's proposed capital structure was unreasonable or the result of imprudent management.

The commission recognized that this decision was consistent with its decision in *Central Telephone Co.*[140] In both cases the commission adopted the actual capital structure of the parent company and rejected a hypothetical capital structure.[141]

On the other hand, in *Peoples Natural Gas Co.*,[142] the commission departed from its prior *Peoples* decision[143] and applied a hypothetical capital structure. The commission rejected the use of the average capital structure of People's parent, InterNorth, proposed by Peoples. The commission noted that, while in the earlier *Peoples* case InterNorth had not been shown to be riskier than a typical gas distribution company, the record in the 1982 case showed that InterNorth had a higher risk, and a correspondingly higher equity ratio, than a typical gas distribution company.[144]

IV. General Observations and Conclusions

As noted at the outset, the Minnesota Supreme Court recognized a

136. *Id.*
137. *Id.*
138. Docket No. G-010/GR-81-780 (Minn. P.U.C. Dec. 30, 1982).
139. *Id.* at 17.
140. Docket No. P-405/GR-81-231 (Minn. P.U.C. May 13, 1982).
141. North Central Pub. Serv. Co., Docket No. G-010/GR-81-780 (Minn. P.U.C. Dec. 30, 1982), at 17.
142. Docket No. G-011/GR-82-65 (Minn. P.U.C. Jan. 28, 1983).
143. Peoples Natural Gas Co., Docket No. G-011/GR-80-850 (Minn. P.U.C. Nov. 25, 1981).
144. Peoples Natural Gas Co., Docket No. G-011/GR-82-65 (Minn P.U.C. Jan. 28, 1983), at 14-15.

number of years ago that the capital structure maintained by a utility must remain within the discretion of management.[145] The pressures capital ratios exert on a utility's ability to maintain credit and attract capital on favorable terms necessitate management discretion. As pointed out by the Florida Public Service Commission:

> Management lives from day today with intricate and complex problems of corporate finance, and has the responsibility of seeing that the utility has the financial ability to meet its public duties. The invasion of the field of management in such a sensitive area is justified only when the public interest requires the exercise of extreme measures for its protection and benefit.[146]

The Minnesota Public Utilities Commission also recognizes these principles. It generally refuses to impose a capital structure for ratemaking purposes substantially different from the actual capital structure maintained by the utility. The significant exceptions involve instances in which the commission adopted a double leverage capital structure that prohibited the parent company from earning the authorized return,[147] and the two instances in which it imposed a purely hypothetical capital structure.[148]

The Minnesota commission's reluctance to impose hypothetical capital structures containing high debt ratios, as advocated by the DPS and OCS, accords with the views of responsible outside financial experts who testify that restraint in this regard is absolutely required in light of prevailing conditions in the capital markets. For example, Eugene E. Meyer, a Vice President and Director of Kidder Peabody & Company, Inc., provided incisive testimony supporting this position in the 1981 Bell rate proceeding[149] and in the most recent *Peoples* case.[150]

Mr. Meyer testified that the marketplace, not the commission, establishes the true cost of capital for a utility. The utility competes for capi-

145. Northwestern Bell Tel. Co. v. State, 299 Minn. 1, 14-15, 216 N.W.2d 841, 850 (1974); *see supra* notes 7-14 and accompanying text.

146. Florida Power & Light Co., 67 P.U.R.3d 113, 162 (Fla. P.S.C. 1966).

147. *See* Northwestern Bell Tel. Co., Docket No. P-421/GR-75-496 (Minn. P.S.C. Oct. 15, 1976); Continental Tel. Co. of Minnesota, Inc., Docket No. PR-121-1 (Minn. P.S.C. Apr. 16, 1976).

148. *See* Peoples Natural Gas Co., Docket No. G-011/GR-82-65 (Minn. P.U.C. Jan. 28, 1983) (discussed *supra* notes 142-44 and accompanying text); Northern States Power Co., Docket No. G-002/GR-78-0152 (Minn. P.S.C. Sept. 9, 1979) (discussed *supra* notes 104, 109-11 and accompanying text).

The capital structure determination, of course, is also affected by whether it is an average test year capital structure, as in the NSP decisions, or end of test year capital structure, as in the Otter Tail discussion, and whether particular items are included or excluded, as in the MP&L decision.

149. Northwestern Bell Tel. Co., Docket No. P-421/GR-80-911 (Minn. P.U.C. Dec. 29, 1981) (transcript Vol. IX, at 3-57).

150. Peoples Natural Gas Co., Docket No. G-011/GR-82-65 (Minn. P.U.C. Jan. 28, 1983).

tal in the marketplace to finance ongoing construction programs or to retire old debt issues. It is to these markets that utility management must take the results of decisions in rate proceedings when new capital is needed. The cost of capital, as established by the marketplace, depends upon a host of political and economic factors, including the utility's ability to place senior securities at reasonable prices and to sell common equity at or above book value.

Mr. Meyer testified that investors in senior securities are primarily concerned with current yield, maintenance of the quality of the investment and, ultimately, principal repayment. Ratings by rating agencies such as Moody's Investor Services, Inc., and Standard & Poor's Corporation are critical factors in determining the price of senior securities.[151] Rating agencies rely heavily upon coverage ratios and capital structures, in addition to other factors, in establishing rating requirements.[152] Thus, a conservative capital structure favorably affects the securities rating and the cost of debt confronted by the utility.

Mr. Meyer testified that the quality of senior securities has seriously deteriorated in recent years. While Moody's and Standard & Poor's downgraded the senior securities of 232 utilities from 1970 to 1980, only 44 achieved higher ratings during the same period.[153] As quality (measured by coverage ratios, capital structure, and regulatory environment) declines, the return provided by the security fails to compensate the investor for the increased risk. When the investor is not compensated for risk, the market value of the security declines and the security becomes marketable.

Mr. Meyer succinctly stated the case in the recent Bell proceeding:

> Excessive debt is the primary culprit responsible for bond rating reductions and indenture violations. With rating reductions and indenture violations comes the inability to finance, in some cases regardless of price. In my judgment, utility companies must strive to reduce the amount of leverage employed in their capital structures. Due primarily to increased competition in the telecommunications markets, inflationary trends in our economy and upheaval in the world energy markets, utility business risks have increased sharply. This higher risk must be

151. For example, during November 1980, the average yield for outstanding "Aaa" bonds was 13.39%; for "Aa" bonds, 13.96%; for "A" bonds, 14.12%; and for "Baa" bonds, 14.79%. The monthly differentials between bond ratings from January 1975 through November 1980 were as follows:

Outstanding Issues Yield Differentials, By Basis Points

Aaa - Aa		Aa - A		A - Baa	
Average	Highest	Average	Highest	Average	Highest
37	122	33	92	54	133

Id. (Transcript Vol. IX, at 23).

152. *Id.* (Exhibit EWM-12) (on file at William Mitchell Law Review office).

153. *Id.* (Exhibit EWM-3) (see Appendix accompanying this article).

offset by lower financial risk; i.e., lower debt ratios and higher equity ratios.[154]

Mr. Meyer's testimony also established that it is important to both stockholders and ratepayers that a utility be able to market its common stock at some margin above book value:

> When new equity capital must be sold at market prices below book value, dilution of earnings per share and assets per share occur. When such a situation continues it becomes ever more difficult to issue new shares except at even lower price levels, thus extending the downward cycle. *The sale of stock at prices below book value requires ever larger rate increases as an offset. As shown by Exhibit EWM-11,*[155] *the sale of common stock below book value requires a higher rate of return on equity just to stay even, let alone meet the requirements of the marketplace.* This is obviously bad for the common stockholder, and though not so obvious, it is also bad for the ratepayer when the next rate case rolls around.[156]

It is also fundamental, according to Mr. Meyer's testimony, that the return on equity is an important measure of a utility's ability to attract new capital:

> The dollars provided by the return on equity provide the coverage on bonds, preferred stock and commercial paper, in addition to the obvious earnings per share and dividends per share.
>
> . . . .
>
> When the return on equity is too low, coverages are inadequate, security ratings are downgraded and the price of the common stock declines below book value. So long as deterioration in the rate of return on equity occurs, earnings per share will decline, finally to the level of the common dividend where the decline must be arrested or the dividend cannot be paid in full. If a utility company begins to reduce its dividend, it is effectively foreclosed from the marketplace for new capital funds.[157]

Given these basic principles, as enunciated by Mr. Meyer, it is apparent that the commission should view recommendations that it adopt a hypothetical capital structure for ratemaking purposes, or adopt substantial adjustments to an actual capital structure, with extreme skepticism. Such recommendations, no matter how couched or supported, if adopted, reduce the utility's return on invested capital to something less than the market prescribed cost of capital. The long term result of the short term reduction in rates obtained in this manner ultimately will be to reduce the utility's financial flexibility and to increase the utility's cost of debt and cost of equity to the detriment of both the shareholders and the ratepayers. The commission should be commended for its past reluc-

154. *Id.* (Transcript Vol. IX, at 40).

155. *Id.* (Exhibit EWM-11) (on file at William Mitchell Law Review office).

156. Northwestern Bell Tel. Co., Docket No. P-421/GR-80-911 (Minn. P.U.C. Dec. 29, 1981) (Transcript Vol. IX, at 36).

157. *Id.* at 37-38.

tance to embark on such a hazardous course of action and should be encouraged to continue carefully scrutinizing all of the ramifications of such recommendations in the future.

V. Appendix

Utility Companies Downgraded by Moody's Investors Service, Inc. and Standard & Poor's Corporation

		SENIOR RATING REDUCED		
*DATE	COMPANY	FROM	TO	BY
1970				
1/14	Connecticut Light & Power	AAA	AA	Standard & Poor's
2/18	Potomac Electric Power	Aa	A	Moody's
2/25	Duke Power	AAA	AA	Standard & Poor's
2/25	Duke Power	Aaa	Aa	Moody's
4/ 7	Trunkline Gas	A	BBB	Standard & Poor's
4/23	Boston Gas	A	BBB	Standard & Poor's
5/13	Monongahela Power	AA	A	Standard & Poor's
6/ 4	Kansas City Power & Light	AAA	AA	Standard & Poor's
6/15	Appalachian Power	AA	A	Standard & Poor's
6/22	Boston Edison	AAA	AA	Standard & Poor's
7/ 2§	Jamaica Water Supply	A	BBB	Standard & Poor's
8/27	Southern Connecticut Gas	A	BBB	Standard & Poor's
8/27	Southern Connecticut Gas	A	Baa	Moody's
9/15	Ohio Edison	AAA	AA	Standard & Poor's
9/29	Carolina Tel. & Tel.	Aa	A	Moody's
9/29	Carolina Tel. & Tel.	AA	A	Standard & Poor's
9/29	Elizabethtown Gas	AA	A	Standard & Poor's
9/29	Elizabethtown Gas	Aa	A	Moody's
12/ 1	Ohio Power	Aa	A	Moody's
12/ 2	New England Power	AA	A	Standard & Poor's
12/ 7	New Bedford Gas & Electric	AA	A	Standard & Poor's
12/ 8	Iowa Electric & Power	AA	A	Standard & Poor's
12/10	Philadelphia Electric	Aaa	Aa	Moody's
1971				
1/13	Florida Power & Light	AA	A	Standard & Poor's
2/ 1	Pennsylvania Power & Light	AA	A	Standard & Poor's
2/18	Jersey Central Power & Light	A	BBB	Standard & Poor's
4/ 1	Ohio Power	AA	A	Standard & Poor's
5/ 4	Wisconsin Public Service	AA	A	Standard & Poor's
5/11	Southern New England Telephone	AAA	AA	Standard & Poor's
6/ 3	Kansas City Power & Light	Aaa	Aa	Moody's
8/10	Consumers Power	AAA	AA	Standard & Poor's
8/19	Pennsylvania Electric	A	BBB	Standard & Poor's
8/26	Hawaiian Telephone	Aa	A	Moody's
8/26	Hawaiian Telephone	AA	A	Standard & Poor's
10/19	Carolina Power & Light	Aa	A	Moody's
10/19	Carolina Power & Light	AA	A	Standard & Poor's
11/ 3	Metropolitan Edison	A	BBB	Standard & Poor's
11/29	Iowa Power & Light	AA	A	Standard & Poor's

Utility Companies Downgraded by Moody's Investors Service, Inc. and Standard & Poor's Corporation

		SENIOR RATING REDUCED		
*DATE	COMPANY	FROM	TO	BY
1971				
(Cont'd)				
11/29	Orange & Rockland Utilities	A	Baa	Moody's
	Orange & Rockland Utilities	A	BBB	Standard & Poor's
	Rockland Electric Company	A	Baa	Moody's
	Rockland Electric Company	A	BBB	Standard & Poor's
	Rockland Light & Power	A	Baa	Moody's
	Rockland Light & Power	A	BBB	Standard & Poor's
1972				
1/17	Kentucky Power	A	BBB	Standard & Poor's
2/ 3	Niagara Mohawk	AA	A	Standard & Poor's
2/ 9	Central Hudson Gas & Electric	AA	A	Standard & Poor's
#	Central Vermont Public Service	A	BBB	Standard & Poor's
2/24	Columbus & So. Ohio Electric	AA	A	Standard & Poor's
3/11#	Rochester Gas & Electric	AA	A	Standard & Poor's
3/22	New England Tel. & Tel.	AAA	AA	Standard & Poor's
#	Iowa-Illinois Gas & Electric	AA	A	Standard & Poor's
#	New Jersey Power & Light	A	BBB	Standard & Poor's
5/17	Pennsylvania Power	AA	A	Standard & Poor's
6/ 6	Consumers Power	Aaa	Aa	Moody's
6/12	Cambridge Electric Light	AA	A	Standard & Poor's
6/29	Baltimore Gas & Electric	AAA	AA	Standard & Poor's
8/14#	New Jersey Power & Light	A	Baa	Moody's
8/16	Jersey Central Power & Light	A	Baa	Moody's
12/ 5	Duke Power	AA	A	Standard & Poor's
12/12	Georgia Power	Aa	A	Moody's
12/12	Georgia Power	AA	A	Standard & Poor's
12/16#	Canal Electric	AA	A	Standard & Poor's
1973				
2/ 5	Commonwealth Edison	AAA	AA	Standard & Poor's
2/14	Consolidated Edison of New York	A	BBB	Standard & Poor's
3/24#	Indiana & Michigan Electric	AA	A	Standard & Poor's
4/14#	Boston Edison Company	AA	A	Standard & Poor's
5/31	Pacific Tel. & Tel. (all Debs. & Notes)	AAA	AA	Standard & Poor's
6/13	Atlantic City Electric	AA	A	Standard & Poor's
9/19	Natural Gas Pipeline	Aa	A	Moody's
11/12	Duke Power	Aa	A	Moody's
12/10#	Boston Edison Company	Aa	A	Moody's
1974				
1/ 7	San Diego Gas & Electric	AA	A	Standard & Poor's
2/ 5	Union Electric	AA	A	Standard & Poor's
3/ 6	Public Service New Hampshire	A	Baa	Moody's
3/ 6	Public Service New Hampshire	A	BBB	Standard & Poor's

Utility Companies Downgraded by Moody's Investors Service, Inc. and Standard & Poor's Corporation

		SENIOR RATING REDUCED		
*DATE	COMPANY	FROM	TO	BY
1974				
(Cont'd)				
3/ 7	Consolidated Edison of New York	A	Baa	Moody's
3/17#	Jamaica Water	Withdrawn		Moody's
3/21	Connecticut Light & Power	AA	A	Standard & Poor's
4/ 1	Baltimore Gas & Electric Co.	Aaa	Aa	Moody's
4/ 2	Wisconsin Power & Light Co.	AA	A	Standard & Poor's
4/ 9	Hartford Electric Light Co.	AA	A	Standard & Poor's
4/18	Western Massachusetts Electric	Aa	A	Moody's
4/18	Western Massachusetts Electric	AA	A	Standard & Poor's
4/27#	Consolidated Edison of New York	BBB	BB	Standard & Poor's
5/14	The Detroit Edison Company	Aa	A	Moody's
5/14	The Detroit Edison Company	AA	A	Standard & Poor's
5/ 1	Cleveland Electric Illuminating	AAA	AA	Standard & Poor's
5/ 6#	Central Vermont Public Service	Withdrawn		Moody's
5/ 6#	Iowa Electric Light & Power	Aa	A	Moody's
5/ 7	Columbus & So. Ohio Electric	Aa	A	Moody's
5/13#	Consolidated Edison of New York	Withdrawn		Moody's
5/13#	Savannah Electric & Power Co.	A	Baa	Moody's
5/20#	Blackstone Valley Electric	A	Baa	Moody's
5/20#	Brockton Edison Company	A	Baa	Moody's
5/20#	Eastern Utilities Associates	Baa	Ba	Moody's
5/20#	Fall River Electric Light	A	Baa	Moody's
5/28	Ohio Power Company	A	Baa	Moody's
6/ 4	Central Illinois Light Company	AA	A	Standard & Poor's
6/ 8#	Savannah Electric & Power Co.	A	BBB	Standard & Poor's
6/13	Delmarva Power & Light	Aa	A	Moody's
6/13	Delmarva Power & Light	AA	A	Standard & Poor's
6/17	Long Island Lighting	AA	A	Standard & Poor's
6/24	Virginia Electric Power	Aa	A	Moody's
6/24	Virginia Electric Power	AA	A	Standard & Poor's
6/26	Boston Edison Company	A	BBB	Standard & Poor's
6/26	Boston Edison Company	A	Baa	Moody's
7/15#	Connecticut Light & Power	Aa	A	Moody's
7/15#	Hartford Electric Light Co.	Aa	A	Moody's
7/17	Consumers Power Company	Aa	A	Moody's
7/17	Consumers Power Company	AA	A	Standard & Poor's
7/23	Toledo Edison	AA	A	Standard & Poor's
8/ 5#	Pennylvania Power Company	Aa	A	Moody's
8/12	Florida Power Corporation	Aa	A	Moody's
8/20	Ohio Edison Company	Aaa	Aa	Moody's
9/21	Florida Power Corporation	AA	A	Standard & Poor's
10/ 1	The Detroit Edison Company	A	Baa	Moody's
10/ 1	The Detroit Edison Company	A	BBB	Standard & Poor's
10/ 3	New York State Electric & Gas	AA	A	Standard & Poor's

Utility Companies Downgraded by Moody's Investors Service, Inc. and Standard & Poor's Corporation

		SENIOR RATING REDUCED		
*DATE	COMPANY	FROM	TO	BY
1974				
(Cont'd)				
10/ 8	Southern California Gas	AA	A	Standard & Poor's
10/ 8	Niagara Mohawk	A	BBB	Standard & Poor's
10/17	Philadelphia Electric	Aa	A	Moody's
10/17	Philadelphia Electric	AA	A	Standard & Poor's
10/22	Dayton Power & Light	Aa	A	Moody's
10/22	Dayton Power & Light	AA	A	Standard & Poor's
10/29	Ohio Power Company	A	BBB	Standard & Poor's
11/19	Cincinnati Gas & Electric	AAA	AA	Standard & Poor's
11/19	Cincinnati Gas & Electric	Aaa	Aa	Moody's
11/19§§	San Diego Gas & Electric	Aa	A	Moody's
11/19	Florida Power & Light	Aa	A	Moody's
12/ 5	Nevada Power	A	BBB	Standard & Poor's
12/23#	Consumers Power	A	Baa	Moody's
12/23#	Georgia Power	A	Baa	Moody's
1975				
1/ 9	Western Massachusetts Electric	A	Baa	Moody's
1/ 9	Western Massachusetts Electric	A	BBB	Standard & Poor's
1/22	Columbus & Southern Ohio	A	BBB	Standard & Poor's
1/23	Hartford Electric Light	A	BBB	Standard & Poor's
1/25#	Georgia Power Company	A	BBB	Standard & Poor's
1/25#	Savannah Electric & Power Co.	BBB	BB	Standard & Poor's
1/27#	Georgia Power Company	Withdrawn		Moody's
1/27#	Savannah Electric & Power Co.	Withdrawn		Moody's
2/10#	Appalachian Power	A	Baa	Moody's
2/19	Arizona Public Service	A	Baa	Moody's
2/24	Houston Lighting & Power	Aaa	Aa	Moody's
2/24	Houston Lighting & Power	AAA	AA	Standard & Poor's
2/24#	Indiana & Michigan Electric	A	Baa	Moody's
2/25	Louisville Gas & Electric	AAA	AA	Standard & Poor's
3/ 3#	Iowa Electric Light & Power Co.	A	Baa	Moody's
3/13**	Carolina Power & Light Co.	A	Baa	Moody's
3/19C	Union Electric Company	Aa	A	Moody's
4/ 8	Cleveland Electric Illuminating	Aaa	Aa	Moody's
4/22	Appalachian Power Company	A	BBB	Standard & Poor's
4/24	Indiana & Michigan Electric Co.	A	BBB	Standard & Poor's
5/ 1	Pacific Power & Light Company	A	Baa	Moody's
5/ 6	San Diego Gas & Electric	A	Baa	Moody's
6/24	United Illuminating	AA	A	Standard & Poor's
6/28#	Central Maine Power Co.	A	BBB	Standard & Poor's
7/12#	Ohio Edison Company	AA	A	Standard & Poor's
9/ 6#	Eastern Utilities Associates	BBB	BB	Standard & Poor's
9/ 6#	Blackston Valley Electric Co.	A	BBB	Standard & Poor's
9/ 6#	Fall River Electric Light Co.	A	BBB	Standard & Poor's

Utility Companies Downgraded by Moody's Investors Service, Inc. and Standard & Poor's Corporation

		SENIOR RATING REDUCED		
*DATE	COMPANY	FROM	TO	BY
1975				
(Cont'd)				
9/29#	Nevada Power Company	A	Baa	Moody's
10/ 8	Toledo Edison Company	Aa	A	Moody's
11/ 5	Central Hudson Gas & Electric	Aa	A	Moody's
11/18	El Paso Electric Company	Aa	A	Moody's
11/29#	San Diego Gas & Electric Co.	A	BBB	Standard & Poor's
1976				
1/21	Hackensack Water	Aa	A	Moody's
1/21	Hackensack Water	AA	A	Standard & Poor's
5/ 5	Central Illinois Light Company	Aa	A	Moody's
5/10	New York State Electric & Gas	Aa	A	Moody's
6/12#	Pacific Power & Light Company	A	BBB	Standard & Poor's
6/24	Toledo Edison Company	A	Baa	Moody's
7/ 5	Alabama Power Company	A	Baa	Moody's
7/20	Ohio Edison Company	Aa	A	Moody's
8/ 7#	Alabama Power Company	A	BBB	Standard & Poor's
8/23#	Arkansas Power & Light Company	A	Baa	Moody's
9/28#	Gulf Power Company	Aa	A	Moody's
12/14	Louisiana Power & Light Co.	A	Baa	Moody's
12/ 6#	Jamaica Water Supply	Baa	Ba	Moody's
1977				
1/24#	The Montana Power Company	Aa	A	Moody's
3/ 5#	The Montana Power Company	AA	A	Standard & Poor's
10/11	Southern California Gas	Aa	A	Moody's
11/16	Kansas City Power & Light	AA	A	Standard & Poor's
1978				
1/11	Pacific Tel. & Tel. Company	Aaa	Aa	Moody's
1/18	Louisiana Power & Light	A	BBB	Standard & Poor's
3/21	Kansas Gas & Electric	Aa	A	Moody's
4/ 3#	Idaho Power Company	Aa	A	Moody's
4/19	Pennsylvania Power Company	A	Baa	Moody's
6/27	Pacific Tel. & Tel.	AA	A	Standard & Poor's
7/29#	Kansas Gas & Electric	AA	A	Standard & Poor's
8/ 7#	Potomac Edison	A	Baa	Moody's
9/23#	Brockton Edison	A	BBB	Standard & Poor's
11/30#	Gulf States Utilities	AA	A	Standard & Poor's
12/ 2#	United Illuminating	A	BBB	Standard & Poor's
1979				
1/15#	Commonwealth Edison	Aaa	Aa	Moody's
2/ 5#	Monongahela Power	A	Baa	Moody's
2/ 7	Pacific Tel. & Tel. Company	Aa	A	Moody's
2/20	Duquesne Light	Aa	A	Moody's

Utility Companies Downgraded by Moody's Investors Service, Inc. and Standard & Poor's Corporation

		SENIOR RATING REDUCED		
*DATE	COMPANY	FROM	TO	BY
1979				
(Cont'd)				
4/ 4	Gulf States Utilities	Aa	A	Moody's
4/23#	Pennsylvania Electric	A	Baa	Moody's
4/23#	Metropolitan Edison	Withdrawn		Moody's
4/28#	Metropolitan Edison	A	BBB	Standard & Poor's
4/24	Gulf Power Company	AA	A	Standard & Poor's
6/21**	Arkansas Power & Light	A	BBB	Standard & Poor's
7/ 2#	Metropolitan Edison	Reinstated	Baa	Moody's
7/17S	Long Island Lighting	Aa	A	Moody's
11/ 7**	Commonwealth Edison	Aa	A	Moody's
1980				
2/ 2#	Metropolitan Edison	BBB	BB	Standard & Poor's
2/ 2#	Jersey Central Power & Light	A	BBB	Standard & Poor's
2/26	Public Service Co. of Colorado	Aa	A	Moody's
2/26	Public Service Co. of Colorado	AA	A	Standard & Poor's
3/ 8#	Mississippi Power & Light	A	BBB	Standard & Poor's
3/19**	New Orleans Public Service Inc.	A	BBB	Standard & Poor's
3/26	Kansas Gas & Electric	A	Baa	Moody's
3/26	Kansas Gas & Electric	A	BBB	Standard & Poor's
3/31#	Jersey Central Power & Light	Baa	Ba	Moody's
3/31#	Metropolitan Edison	Baa	B	Moody's
3/31#	Pennsylvania Electric	Baa	Ba	Moody's
4/ 5#	Ohio Edison	A	BBB	Standard & Poor's
4/12#	Philadelphia Electric	A	BBB	Standard & Poor's
4/19#	Consumers Power	A	BBB	Standard & Poor's
4/28#	United Illuminating	A	Baa	Moody's
6/21#	Commonwealth Edison	AA	A	Standard & Poor's
6/23#	Long Island Lighting	A	Baa	Moody's
7/ 7#	Kansas City Power & Light	Aa	A	Moody's
7/12#S	Long Island Lighting	A	BBB	Standard & Poor's
8/26#	Missouri Power & Light	A	BBB	Standard & Poor's
8/30#	Dayton Power & Light	A	BBB	Standard & Poor's
9/13#	Hartford Electric Light	A	BBB	Standard & Poor's
9/13#	Oklahoma Gas & Electric	AA	A	Standard & Poor's
9/16	Connecticut Light & Power	A	BBB	Standard & Poor's
9/20	Pennsylvania Power	A	BBB	Standard & Poor's
9/23	Duquesne Light	AA	A	Standard & Poor's
10/ 8	Toledo Edison	A	BBB	Standard & Poor's
11/25	Central Hudson Gas & Electric	A	Baa	Moody's
12/ 2	New York State Electric & Gas	A	Baa	Moody's
12/ 3	Houston Lighting & Power	Aa	A	Moody's
12/ 6#	New York State Electric & Gas	A	BBB	Standard & Poor's
12/ 8#	Consumers Power	A	Baa	Moody's

* Represents date of new issue.
** Preferred offering.
# New debt offering not involved. Date, where shown, is Agency's publication date.
§ Private Placement.
§§ Sale was postponed.
C Correction.
S Same rating as Company's General and Refunding Bonds.

Note: Assumed debt of predecessor not listed.
Source: Moody's Bond Survey
Standard & Poor's Bond Outlook and Fixed Income Investor

Electric Utility Companies Upgraded by Moody's Investors Service, Inc. and Standard & Poor's Corporation

		RATING UPGRADED		
DATE	COMPANY	FROM	TO	BY
1970				
March	Kentucky Utilities	A	AA	Standard & Poor's
April	Washington Water Power	BBB	A	Standard & Poor's
July	Gulf Power Company	A	AA	Standard & Poor's
	Gulf Power Company	A	Aa	Moody's
	Texas Electric Service	Aa	Aaa	Moody's
	Montana-Dakota Utilities	Baa	A	Moody's
	Nevada Power	Baa	A	Moody's
	Southern Nevada Power	Baa	A	Moody's
1971				
May	Southwestern Public Service	A	Aa	Moody's
1973				
February	Otter Tail Power	Baa	A	Moody's
	Iowa Southern Utilities	A	Aa	Moody's
April	Pacific Power & Light	BBB	A	Standard & Poor's
May	Pacific Power & Light	Baa	A	Moody's
1974				
	Public Service New Mexico	A	Aa	Moody's
1975				
March	Metropolitan Edison	BBB	A	Standard & Poor's
June	Consolidated Edison of New York	BB	BBB	Standard & Poor's
	Conslidated Edison of New York	Ba	BBB	Moody's
	Iowa-Illinois Gas & Electric	A	AA	Standard & Poor's
October	Wisconsin Public Service	A	Aa	Moody's
1976				
May	Wisconsin Public Services	A	AA	Standard & Poor's
	Wisconsin Power & Light	A	AA	Standard & Poor's
September	Utah Power & Light	A	AA	Standard & Poor's
October	Kentucky Power	BBB	A	Standard & Poor's
1977				
March	Iowa Public Service	A	Aa	Moody's
April	Consolidated Edison of New York	BBB+	A−	Standard & Poor's
May	Jersey Central Power & Light	BBB	A	Standard & Poor's
June	Sierra Pacific Power	BBB	A	Standard & Poor's
July	Niagara Mohawk Power	BBB	A	Standard & Poor's
August	Arizona Public Service	Baa	A	Moody's
September	Carolina Power & Light	Baa	A	Moody's
November	Iowa Electric Light & Power	Baa	A	Moody's
December	Savannah Electric & Power Co.	Ba	Baa	Moody's

1978				
April	Hartford Electric Light	BBB	A	Standard & Poor's
June	Orange & Rockland Utilities	BBB	A	Standard & Poor's
	Rockland Electric	BBB	A	Standard & Poor's
September	Consumers Power	Baa	A	Moody's
	Savannah Electric & Power	BB	BBB	Standard & Poor's
1979				
May	Madison Gas & Electric	A	AA	Standard & Poor's
August	Consolidated Edison of New York	Baa	A	Moody's
	Sierra Pacific Power	Baa	A	Moody's
	Orange and Rockland Utilities	Baa	A	Moody's
	Rockland Electric	Baa	A	Moody's
	Rockland Light & Power	Baa	A	Moody's
1980				
September	Potomac Electric Power	A	Aa	Moody's

Source: Moody's Bond Survey
Standard & Poor's Bond Outlook and Fixed Income Investor